Nasdaq Trader Manual

Notice: This manual is in no way intended to be a substitution for, or relied upon in lieu of, the rules contained in the *NASD Manual*.

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Nasdaq Trader Manual

Revised January 2001

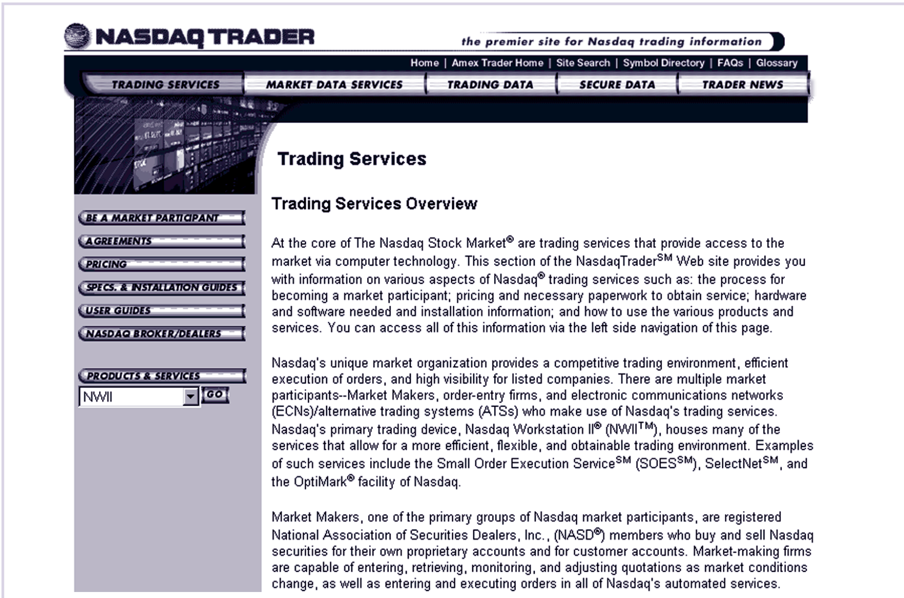
Market Maker Registration

Initial Registration

To quote a Nasdaq® security, your firm must first register as a Market Maker (according to Nasdaq Marketplace Rule 4600). If your firm is an established Nasdaq Market Maker, you can register to quote additional stocks through the "MarketMaking" menu on Nasdaq Workstation II® (NWII™). Effective as of September 24, 2000, you can register immediately to quote a Nasdaq issue. Until the necessary system changes are made, you will need to call Nasdaq Market Operations at (800) 219-4861 to register. The staff will enter your registration for you, which will be effective immediately.

Once you register in a security, the rules require you to enter a quotation in that security within five business day. If you do not enter a quotation within five business days of the effective of your registration in that security, the system will delete your registration in the issue on the sixth business day.

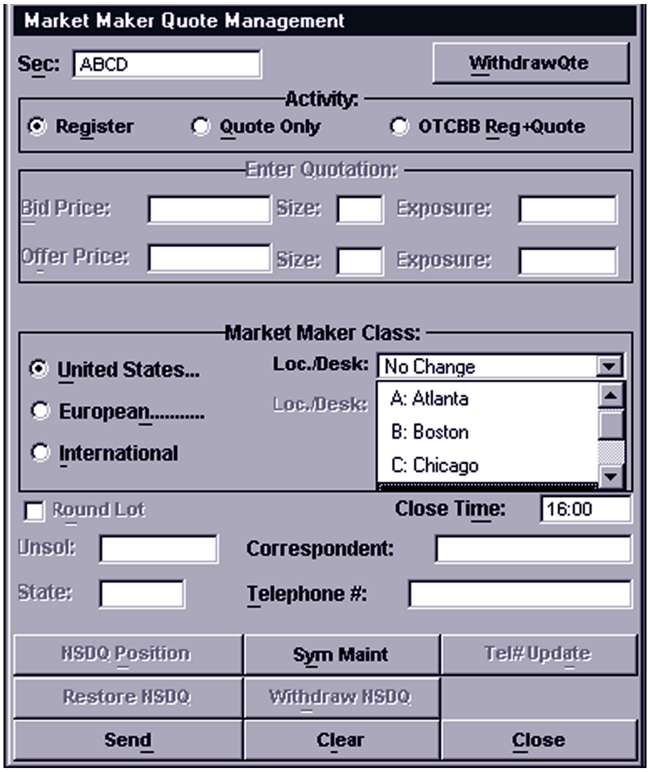
Before you can begin quoting any securities on Nasdaq, your firm must be approved and authorized as a Nasdaq Market Maker. Your firm must meet financial responsibility and other requirements. For more information or to apply to become a Market Maker, please contact the Subscriber Services Department at (800) 777-5606, or visit the "Trading Services" section on the Nasdaq Trader℠ website at nasdaqtrader.com.



[Nasdaq Trader Web Site]

Location Identifiers

When you trade a stock from a location other than your firm's main trading desk — such as from a different city, the foreign desk, the convertible bond desk or arbitrage desk — you must use a fifth-character identifier at the end of your Market Maker identification (MMID) to identify the location at which it is being traded. The fifth-character identifier on the MMID notifies other traders that they should call that location instead of your main Nasdaq trading desk. When you register in the security, use the applicable character in the "Loc./Desk" field of the Market Maker Quote Management window on the Nasdaq Workstation. Please note that the letters (A,B,C, etc.) are not restricted to the cities shown. However, the character, the location it stands for, and the phone number should be identified in the Nasdaq Automated Directory. Call Nasdaq Market Operations at (800) 219-4861 for more information or to request a change in the listing.



[Market Maker Quote Management Window]

Small Order Execution System (SOES)

When you register in a Nasdaq National Market® (NNM) stock, registration in SOES℠ is mandatory and automatic. However, you may need to request SOES routing for delivery of execution messages. When you register as a Market Maker in a security in The Nasdaq SmallCap Market℠ (SmallCap), registration in SmallCap SOES is not mandatory or automatic. If you wish to use SOES for a SmallCap security, you must contact Nasdaq Market Operations. For more information on SOES, see Chapter 4.

Phone Number

Nasdaq Market Operations	(800) 219-4861

Training

To arrange for training or to request training materials, please contact:

Nasdaq Subscriber Training	(212) 858-4084

You may also complete the Subscriber Training request form located at the URL below.
http://nasdaqtrader.com/asp/GetCustomerInfo.asp?2

or send email to Subscribertraining@nasd.com

Revised January 2001

Market Maker Requirements

Firm Quote Rule

Once your firm is registered as a Market Maker in a Nasdaq® issue, you are required by the Securities and Exchange Commission (SEC) and National Association of Securities Dealers, Inc. (NASD®), rules to maintain firm, two-sided, continuous quotations in that issue. This means that you must enter bids and offers in the stocks in which you make markets, and keep those quotations current and accessible during normal market hours of 9:30 a.m. to 4:00 p.m., Eastern Time (ET), Monday through Friday. Electronic communications networks (ECNs)/alternative trading systems (ATSs) are generally the only Nasdaq market participants that may publish one-sided bids and/or offers. Syndicate bids are also one-sided quotes; please see Chapter 3.

The obligation to "keep quotes firm" means that Market Makers and ECNs/ATSs must honor orders presented to them at their quoted prices and sizes at all times during market hours and during the extended trading session (4:00 p.m. to 6:30 p.m., ET) if a firm's quotes are open during such time. The exceptions to this firm quote requirement include when a Market Maker has just executed an order and is in the process of updating its quote, and/or when the Market Maker is updating its quote and has sent a quotation update into Nasdaq. If, as a Market Maker, you are presented with an order at your posted size and price, and you are not in the process of executing another order or updating your quote, you must execute the incoming order. If you do not execute the incoming order, you may be charged with "backing away" from your quote. See discussion of "backing away" in Chapters 4 and 12.

However, if you are a Market Maker or fully participating ECN/ATS/UTP Exchange you have no obligation to execute an order presented through SelectNet®, during the normal market session (9:30 a.m. - 4:00 p.m., ET).

Orders directed through SelectNet to the above market participants during normal market hours cannot be "liability" orders. During the extended session if you are presented with an order at your quoted price but for greater than your displayed size and you execute less than the full size of the order, after such execution you must immediately disseminate an inferior quote. Order Entry only ECN/ATS participants are required to execute directed SelectNet orders at their quoted price and up to their displayed size.

Size Display Requirements

Market Makers are permitted to quote their actual size when displaying interest in a security on the Nasdaq National Market® (NNM) or The Nasdaq SmallCap Market℠ (SmallCap). Thus, a Market Maker must display at least one normal unit of trading (or larger multiple thereof) when it is not displaying a customer limit order in compliance with SEC Rule 11Ac1-4.

Please note that when a Market Maker's quote is executed against in the Small Order Execution System℠ (SOES℠), the system will decrement the quote by the size of the execution in SOES. When the quote is decreased to a size of zero, a Market Maker has five minutes to update its quote. If no action is taken within five minutes, the Market Maker is "SOESed out" in that security for 20 business days. For more information on managing displayed quotes please refer to the Nasdaq User Guide.

Explanation of the Inside Bid and Offer

From all of the Market Maker, ECN/ATS, and UTP participant bids and offers, Nasdaq calculates the highest bid and the lowest offer, and publishes that information on the Nasdaq Workstation II® (NWII™) and through information vendors around the world. The "inside market"—best bid and offer (BBO)—in Nasdaq issues is widely disseminated and used for price discovery purposes and for automated execution parameters.

Effect of SEC Order Handling Rules on Published Prices and Sizes

Some changes to the price and size quotation requirements occurred with implementation of the SEC Order Handling Rules in January 1997. In those rules, the SEC mandated that, with few exceptions, customer limit orders received in a security in which a firm was a registered Market Maker or specialist must either be executed immediately at their limit order prices, must be sent to a Market Maker for immediate execution, or must be reflected in its quote.

Excess Spread Calculation

There are no excess spread rules for quotations in Nasdaq securities.

Locked or Crossed Market Conditions and "Trade-or-Move"

When the best bid equals the best offer, or when the best bid is higher than the best offer, the market is considered to be "locked" or "crossed," respectively. Market Makers and ECNs/ATSs are required by Nasdaq Marketplace Rules to enter and maintain quotations in Nasdaq that do not lock or cross the market. As a Market Maker, you are required to take reasonable steps to avoid locking or crossing the market. An example of a "reasonable step" would be to enter either a SOES or a preferenced SelectNet order (as appropriate) into the system to execute against the bid or offer that your quote would lock or cross. If you don't receive a response within 30 seconds of sending either the SOES or preferenced SelectNet order, you may then display the order in your quote even if that quote will lock or cross the other side. If you follow these steps, you will not be deemed to have violated the Lock/Cross Rule.

See Chapter 4 for more information about SelectNet.

Trade-or-Move

Locks/Crosses Occurring At Or After 9:20 a.m. and Before 9:30 a.m., ET: If a market participant enters a locking/crossing quotation between 9:20:00 a.m. and 9:29:59 a.m. ET, the market participant must immediately send to the Market Maker(s) or ECN(s) being locked/crossed a SelectNet order with a “Trade-or-Move” message appended to the order. The Trade-or-Move order must be priced at (or better than) the quote of the market participant(s) being locked/crossed. The Trade-or-Move order(s) must be an aggregate size of 5,000 shares. This means that if you are locking/crossing a single Market Maker or a single ECN, you must send one Trade-or-Move Message for 5,000 shares. If you are locking/crossing multiple market participants, you must send each Market Maker or ECN a Trade-or-Move Message and the aggregate size of all of these orders must be at least 5,000 shares.

Locks/Crosses Prior To 9:20 a.m., ET: For locks/crosses that occur prior to 9:20 a.m., ET, any party to a lock/cross would have the right, but not the obligation, to send, beginning at 9:20 a.m., a Trade-or-Move Message of any size to any party to the lock/cross. Unlike locks/crosses that occur at or after 9:20 a.m., ET, however, there is no requirement that the market participant initiating the lock/cross send a specific number of shares to those being locked/crossed.

Obligations Regarding “Trade-or-Move Messages”

If you receive a Trade-or-Move Message between 9:20:00 a.m. and 9:29:59 a.m., ET, you must either execute the full incoming order or else move your quote to unlock the market within 30 seconds of receipt of the order. You may partially execute the incoming Trade-or-Move order, but you must then move your quote out of the way within 30 seconds of having received the Trade-or-Move order. In addition, if you execute the full size of the Trade-or-Move order, you can maintain your quote at the locking/crossing price. Thereafter, any party to the lock/cross has the right, but not the obligation, to send a subsequent Trade-or-Move order of any size to any other party to the lock/cross. You would still be obligated to trade with the incoming order or to move your quote, as explained above. If you receive a Trade-or-Move Message and stay at your quote without trading in full, this will be considered a violation of NASD Rule 4613(e). In addition, it could be inconsistent with just and equitable principles of trade for a market participant to send a Trade-or-Move Message when not required to by the rule (e.g., before 9:20 a.m. or after 9:30 a.m.) and/or to send a Trade-or-Move Message that does not meet the requirements of the rule (e.g., at a price that is inferior to the receiving market participant's quote). NASD Regulation, will monitor for violations of Rule 4613(e) and will bring disciplinary action when appropriate.

Exception to this General Rule

The only exception to this rule is situations where the Trade-or-Move Message remains "live" when the market opens (i.e., the 30 seconds to respond to the Trade-or-Move Message carries over into the market's opening) because the lock/cross was created (and the message was sent) in the last 29 seconds before the market opens. You still have an obligation to trade or move within 30 seconds even if the end of that 30 seconds occurs after the market's open. However, the parties to the lock/cross will not have an obligation under Rule 4613(e) to take further action after the 30 seconds has elapsed to resolve the lock/cross that was created prior to the open. Rather, because the Trade-or-Move Message remained "live" when the market opened, the parties to the lock/cross may be deemed to have taken reasonable action to resolve the lock/cross. This assumes that the parties have fully complied with their obligations under the rule by sending timely Trade-or-Move Messages when received.

For more information on locked or crossed market conditions specific to Trade-or-Move see NASD *Notice to Members 00-29* "SEC approves changes to Locked/Crossed Market Rule".

Withdrawal of Quotes

There are two types of quote withdrawals—temporary excused and unexcused. As a Market Maker, you may withdraw a quote on a temporary basis for certain reasons, without having to wait 20 business days to reregister, by contacting Nasdaq Market Operations to effect a temporary or "excused" withdrawal. If you would like to withdraw quotations (Nasdaq Marketplace Rule 4619) on a temporary excused basis, you must first contact Nasdaq Market Operations at (800) 219-4861 (see "Excused Withdrawals" below). In the case of excused withdrawals due to underwriting participation, please refer to Chapter 3 for more information.

If you withdraw quotations on an unexcused basis—whether voluntarily or due to SOES exposure exhaustion—your firm will be subject to a penalty period of 20 business days before it may reregister in the security.

Excused Withdrawals

Following are the reasons why your temporary withdrawal from quoting a stock may be excused:

- Circumstances beyond the control of the Market Maker—such as equipment or communication problems, personal emergency, natural disaster, or other similar reasons.
- Legal reasons (such as investment banking activity), when accompanied by appropriate documentation.
- Vacation, if your firm has three or fewer NWIIs, provided your written request is made one business day in advance.
- Religious observance, provided your written request is made one business day in advance.
- Involuntary failure to maintain a clearing arrangement.
- Passive market making and secondary offering participation.

If your compliance officer instructs you to “get out of a stock,” you should contact Nasdaq Market Operations immediately. You will be advised whether written documentation is necessary, and then Nasdaq will decide whether to effect the withdrawal on an “excused” basis. If you withdraw your quote by keyboard entry, without notifying Nasdaq Market Operations - even if the reason is justified under the rules - you may have to wait 20 business days before you can reregister in the stock. We advise you to call Nasdaq Market Operations whenever you decide to cease making a market in a Nasdaq stock temporarily, to ensure that you remain in compliance.

If one of your traders will be out of the office for a religious observance, it may be possible to obtain an excused withdrawal for the issues traded by that individual. Again, you should contact Nasdaq Market Operations and fax the written request for withdrawal for religious observances at least one business day in advance of the withdrawal date. Send your fax to Nasdaq Market Operations at (800) 219-4861. If only selected securities are to be excused, it is recommended that the fax include a list of those securities.

Similarly, Nasdaq may grant an excused withdrawal for a trader's vacation, if your firm has three or fewer terminals with Nasdaq market-making capability. Your written request must be made at least one business day in advance of the withdrawal and you will need to fax a list of the securities to be excused to Nasdaq Market Operations at (800) 219-4861.

With regard to withdrawals for participation in distributions, please refer to Chapter 3 for information on Nasdaq Marketplace Rule 4619.

Following an excused withdrawal, you are required to reenter quotations into the Nasdaq system promptly. Failure to do so is a violation of the Firm Quote Rules described above, and may then result in a 20-day suspension from making a market in the stock. Once the excused withdrawal period is completed, simply update your bid/offer quotation to reestablish your position in the issue.

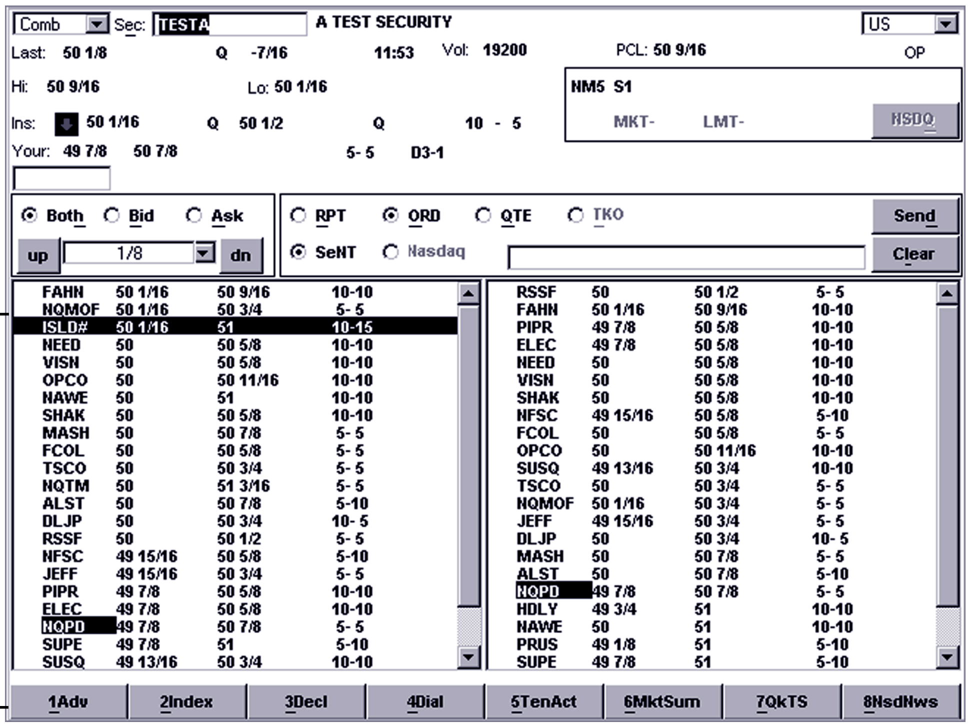
Equipment Problems or Circumstances Beyond Your Control

If your firm is experiencing equipment problems or other circumstances beyond its control, and cannot update its quotes, you must request to close your markets by contacting Nasdaq Market Operations immediately. Your quotations will then appear at the bottom of the Market Maker quote montage with a "C" or "F" notation. The "C" or "F" notation indicates that your quotations are not firm and that you are not subject to SOES executions or responsible for SelectNet liability orders directed to you. Additionally, the "F" indicator means you are willing to receive phone inquiries, although your quotes are not firm.

You may not, however, close your markets because of market volatility. Nasdaq Marketplace Rule 4619 prohibits a withdrawal due to pending news or an influx of orders or price changes, or to trades with competitors. Excused withdrawals are restricted to reasons of “circumstances beyond a Market Maker’s control.”

If you have received an excused withdrawal because you are on vacation, you run the risk of losing that status if you execute orders as a Market Maker in SelectNet during your scheduled vacation time. The use of SOES or SelectNet as a Market Maker while you have excused withdrawal status can cause you to lose your excused status and you may be considered to be in a state of voluntary (unexcused) withdrawal, resulting in a 20-day penalty period.

Market Maker Quote Montage



Appeal Procedure

If your request for an excused withdrawal is denied by Market Operations, you may request an appeal. The Market Operations Review Committee has jurisdiction over such appeals. If you wish to request an appeal, call Nasdaq Market Operations at (800) 219-4861. By rule, your request must be made in writing, but Nasdaq Market Operations will facilitate your hearing and act as liaison between you and the appeal committee.

Voluntary and Accidental Withdrawals

If you have decided not to continue making a market in a Nasdaq security, you may withdraw from it voluntarily by entering a withdrawal through your NWII or other Nasdaq subscriber interface. Once you have done this, you will not be able to reregister to quote the issue for 20 business days, so proceed cautiously. Although Nasdaq Marketplace Rule 4620 makes allowance for accidentally withdrawing from a stock, we strongly recommend that your firm have a withdrawal procedure in place. For example, your head trader, compliance officer, or other responsible party should make sure that there is no further trading interest in the stock and that there is no pending investment banking or syndicate involvement in the issue.

If you have accidentally withdrawn from an issue, call Nasdaq Market Operations at (800) 219-4861 immediately. Your verbal request must be made as soon as possible, but no more than 60 minutes from the time of withdrawal. You must fax a written confirmation of your verbal request to Nasdaq Market Operations at (800) 219-4861, immediately. Nasdaq Market Operations requires that the request be approved by your firm's head trader, compliance director, or other authorized individual, and that the written confirmation be submitted by one of these people.

Your registration may be reinstated if it is clear that the withdrawal was inadvertent and not an attempt to avoid market-making obligations. Other factors that may be considered are the timeliness of the request, market conditions at the time of withdrawal, the number of such reinstatements for the firm, etc. Firms are subject to the following reinstatement limits: a firm that made less than 250 markets during the previous calendar year cannot receive more than two reinstatements; firms that made at least 250 markets, but less than 500 markets can receive up to three reinstatements; firms that made 500 or more markets can receive up to six reinstatements per year.

If your request to Nasdaq Market Operations for reinstatement due to an accidental withdrawal is denied by Nasdaq Market Operations, you may appeal to the Market Operations Review Committee, which has jurisdiction over such matters. Follow the procedure previously described.

SOES Withdrawal

With regard to withdrawal due to SOES executions under Nasdaq Marketplace Rule 4700, if your size in a Nasdaq National Market stock is reduced to zero through SOES executions, your quote is placed in a “SOES closed” state. You will be given a grace period (currently five minutes) to reenter a quotation. If you do not reenter a quote within that period, the system will suspend your quote in that issue for 20 business days. See Chapter 4 for more information on SOES.

If your firm experiences system problems and you are not able to update your quotes before the five-minute window elapses, you must contact Nasdaq Market Operations to have your quotes temporarily withdrawn. Nasdaq Marketplace Rule 4730 stipulates that if your ability to update quotations becomes impaired due to equipment or communication problems, you must contact Nasdaq Market Operations to have your market placed in a “closed” state. You are liable for any executions until this is done and subject to the 20-day period if you are “SOESed-out-of-the-box.” See Chapter 4 for information on responding to SOES executions.

Nevertheless, if you are suspended in a security due to SOES exhaustion, you can seek reinstatement of your registration by contacting Nasdaq Market Operations as soon as possible after the withdrawal, but no more than 60 minutes later. You must fax a written confirmation of your verbal request to Nasdaq Market Operations at (800) 219-4861, immediately. To be considered for reinstatement, you must be a primary Market Maker in the issue and a designated officer of Nasdaq must determine that there was no attempt to avoid market-making obligations. Firms are limited to the total number of “SOES registration reinstatements” as follows: firms that made less than 250 markets during the previous calendar year cannot receive more than four reinstatements; firms that made 250 markets, but less than 500, are limited to six reinstatements; firms that made 500 or more markets can receive no more than twelve reinstatements.

Even if your firm has reached its limit on reinstatements, under certain circumstances a designated Nasdaq officer may grant a reinstatement if it is believed that it is necessary to maintain a fair and orderly market. Such reasons may include a documented system failure at the firm, lack of Market Makers in an issue, or if the firm is a manager or co-manager of a secondary offering in the affected stock. Please note that chronic system problems under the control of a firm will not be considered.

If your request for reinstatement due to a SOES withdrawal is denied by Nasdaq Market Operations, you may appeal to the Market Operations Review Committee, which has jurisdiction over such matters. Follow the procedure previously described.

Convertible Bonds

Convertible bonds are listed on Nasdaq and in many ways appear to be treated as equities, but some of the Market Maker requirements, as explained below, differ from equities. Convertible bonds do not have an "NM" or "N" symbol on the NWII screen to denote National Market or SmallCap, respectively.

Quotations

Quotations in convertible bonds listed on Nasdaq are required to be firm, continuous, and two-sided, as they are with Nasdaq equities; but, convertible bonds are exempt from the quotation size requirements of Nasdaq equities. Convertible bonds are not subject to SOES executions.

Unit of Trading

The generally accepted unit of trading for a convertible bond is 10 bonds, at a face value of $1,000 each.

Trade Reporting Requirements

Trades in convertible bonds must be reported to Nasdaq within 90 seconds of execution through the Automated Confirmation Transaction Service℠

(ACT℠), similar to transactions in equity securities; however, only trade reports in units of 99 bonds or less will be disseminated to the public.

Limit Order Protection Rule

The Limit Order Protection Rule provides that a member firm may negotiate terms and conditions with customers who have limit orders of 10,000 shares or more, so long as the value of the order is $100,000 or more. The Interpretation does not address the size limit for convertible bonds directly, but by implication, there is a comparable-size restriction for convertible bonds. A unit of trading for convertible bonds quoted on Nasdaq is 10 bonds or $10,000 original principal amount; so, for the purposes of the Short Sale Interpretation, an institutional-sized convertible bond limit order is 100 bonds or $100,000. Therefore, a member firm can negotiate terms and conditions with a customer with a convertible bond limit order of $100,000 or more. For more general information on limit order protection, see Chapter 7.

Unlisted Trading Privileges (UTP)

Section 12(f) of the Securities and Exchange Act of 1934 permits exchanges to extend "unlisted trading privileges" (UTP) to securities listed on other U.S. securities exchanges or markets. Through UTP, other exchanges and markets are able to compete with, and attract order flow from, the primary market—the market or exchange that lists a particular security. Unlike the primary market, a market that trades a security pursuant to UTP has no contractual or other relationship with the issuer. The SEC has traditionally endorsed and supported UTP trading because such activity promotes competition among markets which, in turn, contributes to greater liquidity and depth, enhancing pricing efficiency, and increasing opportunities for investors to receive the best execution of their orders.

Although all securities listed on the Nasdaq National Market and the New York and American Stock Exchanges are eligible for UTP trading by other markets or exchanges, there is a limit to how many Nasdaq National Market securities an exchange can trade at one time, pursuant to UTP rules. Currently, the limit is

1,000, and the Chicago Stock Exchange is the only UTP participant actively trading securities.

Trading With an Exchange

Transactions in Nasdaq National Market securities traded on an exchange are not subject to the NASD Short Sale Rule, but may be subject to applicable rules governing trading on the particular exchange. In addition, orders that are sent to the floor of an exchange and executed there are generally reported by the exchange, and thus, the NASD member should not report these transactions again.

Exchanges that trade Nasdaq stocks via UTP now have access to SelectNet. Thus, NASD members and exchange specialists can now access each other's quotes. This is important in light of the SEC Order Handling Rules, because quotes of UTP exchanges trading Nasdaq stocks are reflected in the Nasdaq quote montage.

Primary Market Making

Primary Market Maker standards were adopted when The Nasdaq Stock Market® implemented the NASD Short Sale Rule. The Primary Market Maker standards were designed to reward Market Makers that added liquidity to the market by giving them an exemption to the Short Sale Rule. For more information on short sales, see Chapter 9.

The primary market-making standards in Nasdaq Marketplace Rule 4612 (time at the inside, spread, quote/trade ratio, and proportionate share volume) were suspended on February 3, 1997. Only the "Secondary Hold" Rule remains in effect. This rule prohibits Market Makers that are not making a market in a stock at the time of the announcement of a secondary distribution from becoming primary Market Makers in that issue for 40 calendar days or until the offering becomes effective.

Primary Market Makers are exempt from the Short Sale Rule, thereby allowing them to sell short at the bid on a down tick. At this time, any registered Market

Maker in a Nasdaq National Market issue is considered a Primary Market Maker in that issue. Primary market making does not pertain to Nasdaq SmallCap issues or to OTC Bulletin Board® (OTCBB) issues, as they are not subject to the Short Sale Rule.

Autoquoting

Autoquoting to keep your quote in a Nasdaq security away from the inside market is not permitted. (UTP exchanges are, however, permitted by the rules in their markets to do this type of autoquoting.) Autoquoting is generally permitted when your firm is updating its quote following an execution.

Your firm may also autoquote to display customer limit orders that reside in an internal execution system.

Phone Numbers

Nasdaq Office of General Counsel	(202) 728-8294
Nasdaq Market Operations	(800) 219-4861

Fax Number

Nasdaq Market Operations	(203) 385-6380

Training

To arrange for training or to request training materials, please contact:

Nasdaq Subscriber Training	(212) 858-4084

You may also complete the Subscriber Training request form located at the URL below.
http://nasdaqtrader.com/asp/GetCustomerInfo.asp?2

or send email to Subscribertraining@nasd.com

Distribution Requirements

Initial Public Offerings—IPOs

Registration

Once an initial public offering (IPO) has been approved for listing, the symbol is entered into the Nasdaq® system and is made available for registration. Securities available for registration are included on the Nasdaq News frame, which is accessed through the "InfoSvcs" menu located on the main menu bar of Nasdaq Workstation II® (NWII™), with the code "SR" indicated on the far right. If you wish to register as a Market Maker for the next day, you may do so through the "MarketMaking" menu on your NWII.

Nasdaq rules allow Market Makers to register on-line during the first five days of quoting the new security. To register on-line on the day the issue is released for trading, contact Nasdaq Market Operations at (800) 219-4861. See "Registering for IPOs and Syndicates" in Chapter 1 for more information.

Release

To release an IPO on Nasdaq, if your firm is the underwriter, you must contact Nasdaq Market Operations and provide the time and date of Securities and Exchange Commission (SEC) effectiveness; confirm the final price and number of shares offered; and confirm the settlement (closing) date of the offering and the time the security is to be released for trading.

When the security is being released for trading, Nasdaq provides a 15-minute window that allows all Market Makers registered to trade in the stock an opportunity to enter and adjust quotes before the issue is released for trading. If the market is locked or crossed at the end of the initial 15-minute window, an additional 15-minute quotation-only period will be provided before trading may begin. Information on this 15-minute window, including quotation and trading release times, is available in the Nasdaq News frame.

Secondary Public Offerings—SPOs

Registration

Since Nasdaq securities that are the subject of secondary distributions are currently being quoted, potential Market Makers may only register for next-day quotation. If your firm is manager or co-manager of the offering, and not registered in the subject security on the effective date of the registration statement, you may contact Nasdaq Market Operations at (203) 219-4861 to be registered on-line.

Passive Market Making

Under SEC Rule 103 of Regulation M, Market Makers participating in a secondary offering are permitted to continue market-making activities during the one- or five-day restricted period prior to the commencement of the distribution, if engaged in “passive market making.” Otherwise, as a Market Maker, you are required to withdraw quotations on an excused basis pursuant to SEC Rule 101.

Only Nasdaq securities that are the subject of firm commitment, fixed-price offerings may be eligible for passive market making.

SEC Rule 103 (replacing Rule 10b-6A) permits passive market making on Nasdaq during the restricted period of Rule 101, when market making by distribution participants otherwise is prohibited. Rule 103 limits the price levels of bids and purchases that you can make as a Nasdaq passive Market Maker.

The rule generally limits a passive Market Maker’s bid to the highest current independent bid (i.e., the bid of a Nasdaq Market Maker that is not participating in the distribution) during the restricted period.

It limits you to the amount of net purchases that you can make on any one day to 30 percent of your Average Daily Trading Volume (ADTV). An initial ADTV limit of 200 shares is set for less active Market Makers.

Underwriting Requirements

After filing the offering document with the SEC, the manager of the distribution must file the offering and other information with the Corporate Financing Department of NASD Regulation, Inc., and request an Underwriting Activity Report. The appropriate trading statistics will be calculated and the report issued to the manager, indicating the number of restricted days required under Regulation M. This is the period during which a distribution participant will engage in passive market making or be excused from quoting in the Nasdaq system.

If you are the manager of the underwriting, you must forward a copy of the completed Underwriting Activity Report to Nasdaq Market Operations—no later than one business day before the commencement of the restricted period—indicating those participants that will engage in passive market making or will be excused, and the effective date(s) of the restricted period. If you are a distribution participant, you may change your status voluntarily during the restricted period by contacting Nasdaq Market Operations at (203) 375-9609.

Purchase Limitations

On each business day of the restricted period, your net purchases (purchases in excess of sales) as a passive Market Maker may not equal or exceed 30 percent of your ADTV in that security during the restricted period. Your ADTV is derived from the NASD® Monthly Activity Report and is available from the underwriting activity report issued by the NASD Regulation® Corporate Financing Department.

If your net purchases equal or exceed 30 percent of your ADTV at any time during the restricted period, you must withdraw your quotations from Nasdaq immediately for the remainder of that day, regardless of any subsequent sales. Prior to equaling or exceeding the ADTV you may purchase all of the shares that are part of a single order that, when executed, results in your net purchase limitation being equaled or exceeded. After that purchase is effected, you must withdraw your quotations immediately.

Passive Market Makers must not purchase stock on a principal basis at a price higher than the highest independent bid, which includes purchases through electronic communications networks (ECNs)/alternative trading systems (ATSs).

Quotation Limitations

As a passive Market Maker, your displayed size may not exceed your remaining purchasing capacity.

At the open, you may not quote a bid higher than the highest independent bid.

During trading hours, you may not initiate a bid above the highest independent bid, and in instances where only passive Market Makers are at the inside bid, you may not raise your bid to join other passive Market Makers at the inside bid. However, if you receive an unsolicited customer limit order, you must display the quote in accordance with the Limit Order Display Rule.

Identification of a Passive Market Making Bid

The bid displayed by a passive Market Maker will be designated with a “PSSM” on the screen.

When entering quotes on the first day of passive market making, make sure the bid you display does not exceed your 30 percent ADTV net purchase limit.

Excused Withdrawal

If you meet or exceed your 30 percent ADTV net purchase limit, you must withdraw your quotes from the NWII or execute a sale that would bring your net position under the 30 percent ADTV limit. In either instance, you must respond within 30 seconds of the executed trade. If you withdraw your quote, you must contact Nasdaq Market Operations so they can place the quote in an excused withdrawal state.

Stabilizing Bids

Underwriters or other designated Market Makers may enter stabilizing bids for the purpose of maintaining the price of a security pursuant to SEC Rules 101 and 104 of Regulation M.

A stabilizing bid cannot be initiated through your NWII. Nasdaq Marketplace Rule 4614 requires you to notify Nasdaq Market Operations of your intent to enter a stabilizing bid. You must also send Nasdaq Market Operations written confirmation of your stabilizing bid by the close of business on the day the one-sided stabilizing bid is entered. Confirmation should be in the form of an Underwriting Activity Report, or, if the report is not available, written confirmation must include the name and symbol of the security, the contemplated effective and pricing date, the date and time of the stabilizing bid, and the cover page of the offering document. No more than one Market Maker may stabilize in a security at one time. The stabilizing bid will be identified with a modifier on the screen.

When you are in a stabilizing (one-sided market) condition, you are not eligible to participate in the Small Order Execution System℠ (SOES℠).

Penalty Bids

Penalty bids are entered to track sales in the market by syndicate members, and for which selling concessions will be withheld by the underwriter. They are governed by SEC Rules 101 and 104 of Regulation M.

Since a penalty bid cannot be entered through a Market Maker's terminal, you must notify Nasdaq Market Operations of your intentions. Nasdaq Marketplace Rule 4623 requires written confirmation no later than the close of business on the day that the penalty bid is imposed. Notice must include the name and symbol of the security and the date of imposition of the penalty bid. Notice must also be sent to the NASD Regulation Corporate Financing Department.

Only one penalty bid may be in effect for any security at one time. A penalty bid will be identified with a modifier on the screen, at the option of the member.

Phone Numbers

Nasdaq Market Operations	(800) 219-4861
NASD Regulation Corporate Finance	(240) 386-4623

Nasdaq Execution Services: SOES and SelectNet

Nasdaq® operates two automated execution systems—the Small Order Execution System℠ (SOES℠) and SelectNet®. SOES is a system that provides automatic execution of market and marketable limit orders while SelectNet offers delivery of orders with the ability to negotiate or execute those orders. The operation of both systems has been reviewed and approved by the Securities and Exchange Commission (SEC), and to make changes in those operations requires SEC approval.

Overview of SOES

SOES is an automated trading system that lets SOES participants enter and execute orders of limited size in active SOES-authorized Nasdaq securities. Reports of these executions are sent to the Automated Confirmation Transaction Service℠ (ACT℠) as locked-in trades, then both sides of the transaction are sent to the applicable clearing corporation(s) for clearance and settlement, and the trade is reported to the tape.

Both The Nasdaq SmallCap Market℠ and Nasdaq National Market® securities are eligible for trading through SOES. The stocks are separated into tiers representing the largest order for a given stock that can be entered into SOES. National Market securities are separated into tiers of 200, 500, and 1,000 shares, depending on the trading characteristics of the stock. SmallCap securities are separated into 100- or 500-share tiers.

All order-entry firms and Market Makers registered with Nasdaq have access to SOES. Electronic communications network (ECN)/alternative trading system (ATS) and unlisted trading privileges (UTP) participant quotes do not participate in SOES.

Hours of Operation

SOES orders priced as “market” may be entered into the system beginning at system open (7:30 a.m., Eastern Time [ET]) for execution at market open (9:30 a.m., ET). Marketable limit orders and market orders may be entered into SOES during the normal market hours of 9:30 a.m. to 4:00 p.m., ET.

Participation

SOES participation is mandatory for Market Makers in Nasdaq National Market securities and voluntary for Market Makers in the SmallCap Market. All National Association of Securities Dealers, Inc. (NASD®), member firms may participate in SOES if they:

- are a member of the National Securities Clearing Corporation (NSCC);
- have a clearing arrangement with an NSCC member; or
- clear through a clearing corporation recognized by the NSCC.

Types of Orders

SOES accepts market orders and marketable limit orders. All-or-none (AON); fill-or-kill (FOK); good ’til canceled (GTC); and good ’til date (GT Date) orders are not permitted in SOES.

SOES accepts orders that are either preferenced to a particular Market Maker or unpreferenced. A preferenced order will be executed against the Market Maker to which the order is directed, at the inside market price, and unpreferenced orders will be executed against Market Makers in rotation, at the inside quote.

Market Makers may establish those order-entry firms from which they will accept preferenced orders.

SOES Executions

Orders are automatically executed within SOES and the report of execution is sent to the Market Maker and to the order-entry firm. Market Makers have 17 seconds between executions to update their quotations. Market Makers at the inside bid or offer automatically execute unpreferenced SOES orders up to the size of their displayed quote. Preferenced SOES orders are executed by a specified Market Maker up to the maximum order size—regardless of their displayed quote size—at the inside quote price. Execution of preferenced SOES orders does not reduce (or decrement) a Market Maker's displayed size or supplemental exposure.

To Manage Quotes Following SOES Executions

Firm-quote obligations apply to a Market Maker's displayed quote size.

Nasdaq Market Makers in Nasdaq stocks may quote actual size when displaying proprietary interest in all stocks listed in both the National Market and SmallCap Market. A Market Maker's minimum quotation size obligation will be no less than 100 shares (or one normal unit of trading) whether the firm is displaying a proprietary interest or reflecting a customer limit order.

When a Market Maker's quote is executed against in SOES, the system decrements (decreases) the quote by the size of the order. When the quote is decreased to a size of zero, a Market Maker has five minutes in which to update its quote. If no action is taken within five minutes, the Market Maker's registration is suspended in that security for 20 business days (SOESed-out-of-the-box). Nasdaq provides an auotmated quote refresh feature to prevent being SOESed-out-of-the-box, which may occur when a Market Maker uses this decremental feature. The automated quote refresh feature updates the Market Maker's price and size based on refresh parameters set by the Market Maker.

A Market Maker must update its quote when its size is exhausted—within five minutes for a Nasdaq National Market security and by system close (6:30 p.m., ET) for a SmallCap security.

Any time a Market Maker updates its quotation without specifying a quote size, Nasdaq will automatically reset the quote size so that it is equal to the SOES tier size in that security (i.e., 200, 500, or 1,000 shares). If the Market Maker specifies a quote size, it will be accepted as entered. Only the side that was updated will be changed if the default quote size occurs.

Market Makers have four options in response to a SOES execution:

(1) **Maintain displayed size only, with no supplemental exposure.** Your displayed size will decrement on the appropriate side following each SOES execution. When your displayed size is reduced to zero, your quote will be upticked or downticked on the appropriate side based on a predetermined price increment, if you are using the auto-refresh feature. Your displayed quote size will be restored to the SOES tier size or the size selected by the Market Maker when specified. If you have elected not to use the auto-refresh capability, your quote will be placed in a "SOES closed" state. If the quote is not updated within five minutes, you will be placed in a "Quote Suspended" state (or SOESed-out-of-the-box) for a 20-business day penalty period.

(2) **Maintain displayed size and supplemental exposure, equal to or greater than the SOES tier size.** Your displayed size and supplemental size will decrement following each SOES execution. If the displayed quote size is reduced to zero, but you still have supplemental exposure size in that security, your quoted price will remain the same; its size will be restored to the SOES tier size automatically; and the quote will be re-ranked at the bottom of the montage at its price level. If both the displayed quote size and supplemental exposure size are reduced to zero, you may update your quote and size manually, or rely on the auto-refresh capability described above. You must restore your supplemental exposure size manually—the system will not automatically refresh your exposure size.

(3) **Maintain displayed size and unlimited supplemental exposure size (e.g., 999,999).** Your displayed size will decrement following each SOES execution, but your supplemental exposure size will not decrement. If your displayed quote size is reduced to zero, your quote remains the same, but your displayed size will be restored to the SOES tier size from the supplemental exposure size, and the quote is re-ranked to the bottom of the quote montage at its price level.

(4) **Maintain displayed size and select the "NO DEC" option (e.g., 999,998).** Your displayed size and supplemental exposure size will not decrement following

a SOES execution if the "NO DEC" option is selected on the workstation screen. Your quoted price and size will not be updated following a SOES execution and you will not lose your position in the ranking on the quote montage. You are not permitted to use this feature unless you publish a size greater than or equal to the SOES tier size of 1,000, 500, or 200 shares for the particular security. The only exception is when you are using your own internal system to reflect customer limit orders in sizes lower than SOES tier size.

You can elect to update quotes automatically by a predetermined tick value or update them manually after their displayed quote sizes (and supplemental exposures) are reduced to zero. The option to update quotes automatically may be selected on a security-by-security basis.

SOES Closed Quotes

If your displayed size is reduced to zero in a Nasdaq National Market security, your quote is placed in a "SOES closed" state and re-ranked at the bottom of the quotes displayed in the quote montage with an "n" indicator to the left of the size display.

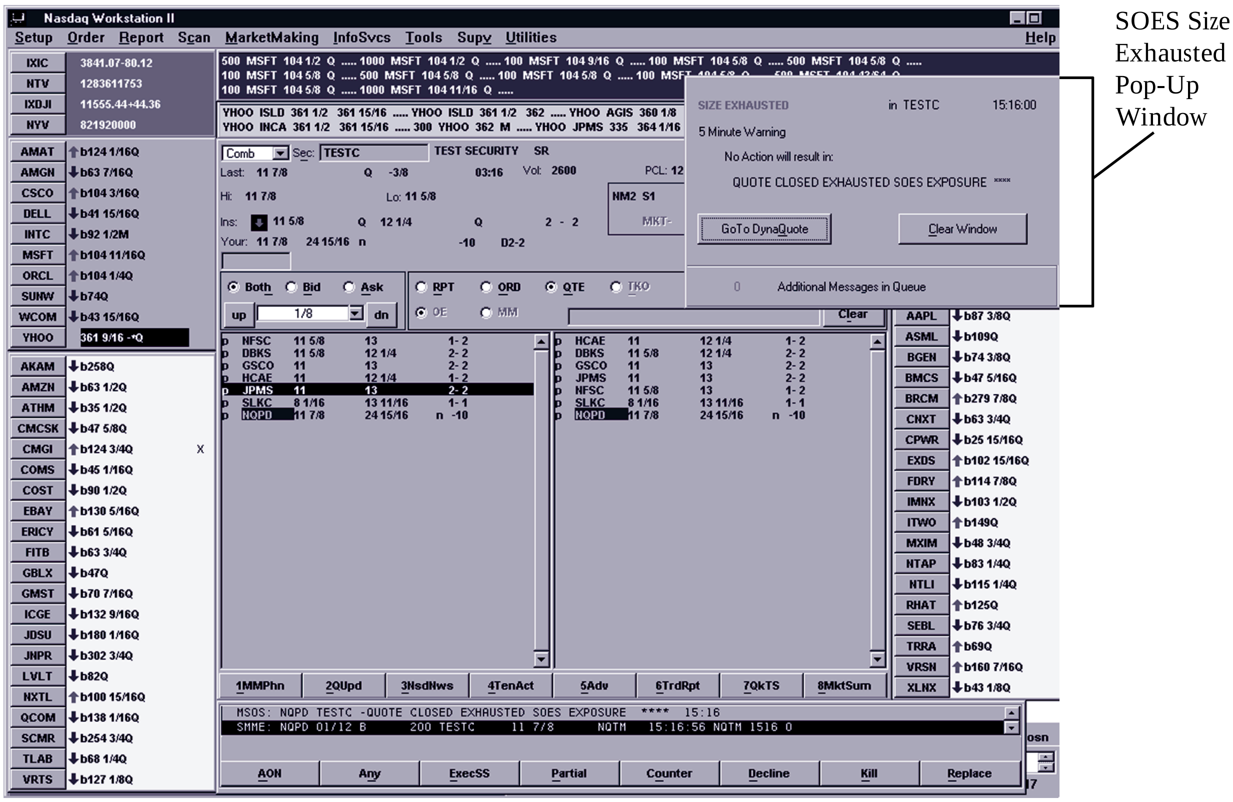
If you do not update your quote in a Nasdaq National Market security within five minutes, your quote is placed in a "SOES suspended" state for 20 business days.

If your displayed size is reduced to zero in a Nasdaq SmallCap security, your quote is placed in a "SOES closed" state, re-ranked at the end of the quotes displayed in the quote montage, and withdrawn from the SOES rotation until you update your quote and restore yourself to SOES. If you do not update your quote before 6:30 p.m., ET, of the same trading day, Nasdaq will withdraw your quote for 20 business days.

If your displayed quote size is reduced to zero during the last five minutes of the trading day (3:55 to 4:00 p.m., ET), your quote will show no size on the side of the market that was decremented to zero. You have until 6:30 p.m., ET, on that day to re-open your quote and re-establish your displayed size. If you fail to restore your displayed size before the 6:30 p.m., ET, cutoff time, your firm will be withdrawn from the security for 20 business days. This procedure applies to all Nasdaq National Market and SmallCap securities.

Warning Messages in SOES

You can elect to have a “SOES Size Exhausted” pop-up window appear on your Nasdaq Workstation screen when your displayed quote size and supplemental exposure size in a security are reduced to zero due to SOES executions.



[Nasdaq Workstation II® Screen]

The display of a “SOES Size Exhausted” pop-up window does not affect the availability of all other Workstation functions. If another window is accessed while the pop-up window is displayed, the pop-up window will move behind the active window. If the size in another security is reduced to zero while the pop-up is in the background, the pop-up will reappear and display a new warning message.

It is possible to receive more than one “SOES Size Exhausted” warning at a time. There is a section on the pop-up window, “Additional Messages in Queue,” that alerts the trader to the number of additional warnings pending. Each time you respond to the pop-up window, the “Additional Messages in Queue” number is reduced by one.

ECN/ATS or UTP Participants Alone at the Inside

ECN/ATS and UTP quotes are accessible only through SelectNet. Accordingly, if an ECN/ATS or UTP participant is alone at the inside in a Nasdaq National Market security, SOES orders will be held in queue for a specified period of time, initially set at 90 seconds. This “hold time” will: (1) allow the ECN/ATS to move away, creating a new inside; (2) give the Market Makers time to adjust their quotes to create a new inside; or (3) allow the Market Maker to join the ECN/ATS at its price. If one of these occurs within 90 seconds, the order will execute (or be rejected if it is no longer executable). If none of these conditions occur when an ECN/ATS or UTP exchange is alone at the inside, the order will time out at the end of the 90 seconds and be returned to the entering firm.

In SmallCap, however, the SOES system will continue to execute against the next available SOES Market Maker at the ECN/ATS or UTP price.

SOES Operations in Locked/Crossed Markets

During normal conditions, a Market Maker has 17 seconds between SOES executions. When the market in a security is locked or crossed, SOES will continue to execute orders, but there will be only a five-second period between SOES executions.

Short Sales Through SOES

Short-sale orders are permitted in SOES, but will be executed in compliance with the NASD Short Sale Rule. Trades executed through SOES against Market Makers are not subject to the ACT short-sale reporting requirements because Market Makers have no control over the timing of executions that are received through the system.

Fees for SOES

Any SOES Market Maker that executes an order or part of an order will be charged $0.50 per transaction. The firm that enters the order will be charged $0.50 per transaction, also. There is a $0.25 charge for the cancellation of an unexecuted SOES order.

Orders that time out are not considered cancellations for the purposes of this fee and, therefore, are not included in the fee calculation. The most up-to-date fees for SOES are available in the "Trading Services" section on the Nasdaq Trader℠ Web site at *www.nasdaqtrader.com*, or by calling Nasdaq Subscriber Services, at (800) 777-5606.

Overview of SelectNet

SelectNet offers traders the ability to automate the negotiation and execution of trades. Orders of any size up to six digits can be entered into SelectNet. Executions are automatically reported to ACT for public dissemination and sent to clearing for comparison and settlement.

SelectNet allows order-entry firms and Market Makers to direct orders to specified Market Makers, UTP participants, or ECNs/ATSs, or to broadcast orders to all participants quoting the issue. SelectNet also identifies incoming and outgoing orders and allows the market participant to see subsequent messages and negotiation results.

If a SelectNet order is directed to a specific Market Maker and is delivered to that Market Maker priced at the Market Maker's current bid or offer at the time of order receipt, the Market Maker is subject to the Firm Quote Rule and has liability for its quoted price up to its displayed size.

A participant may respond to an order that is delivered to its terminal by:
(1) accepting the order;
(2) price improving the order;
(3) declining the order, consistent with Firm Quote Rule requirements;
(4) countering or accepting a portion of the order; or
(5) allowing the order to expire or time out.

When an order is countered, negotiations begin and the two parties exchange messages until they produce a full or partial execution, decline the transaction, or the transaction times out.

Participation

All Nasdaq order-entry firms or Market Makers may participate in SelectNet if they:

- are a member of the NSCC;
- have a clearing arrangement with an NSCC member; or
- clear through a clearing corporation recognized by the NSCC.

ECNs/ATSs that choose to link into Nasdaq must agree to participate in SelectNet as part of that linkage. Full UTP participant exchanges may also use SelectNet.

Hours of Operation

Normal trading hours:	9:30 a.m. to 4:00 p.m., ET
Before- and after-hours trading:	9:00 to 9:30 a.m. and 4:00 to 6:30 p.m., ET

SelectNet as an ECN/ATS

SelectNet is not considered an "Eligible ECN/ATS" for the purposes of complying with the SEC Limit Order Display Rule or the ECN/ATS alternative of the Limit Order Display Rule. Accordingly, you cannot use the SelectNet broadcast as an ECN/ATS in which Market Makers are allowed to display customer limit orders (rather than reflecting them in their quotes) under the ECN/ATS alternative to the Limit Order Display Rule.

If you enter a broadcast order into SelectNet for display to all other Market Makers and your order is priced better than your displayed Nasdaq quote, you must change your Nasdaq quote to show the better price that you have displayed through the SelectNet broadcast. However, you are not required to change your quote if the order is preferenced to a single Market Maker or to an eligible ECN/ATS.

Using SelectNet to Link to Other ECNs/ATSs

SelectNet has been designated as the vehicle to link the Nasdaq market with ECNs/ATSs for application of the SEC Order Handling Rules. Participants may preference orders in SelectNet to a particular ECN/ATS for execution, but no special condition orders are allowed into SelectNet for routing to an ECN/ATS. Special conditions include: all-or-none orders, non-negotiable orders, and orders that include a minimum acceptable quantity for execution.

SelectNet Cancellations

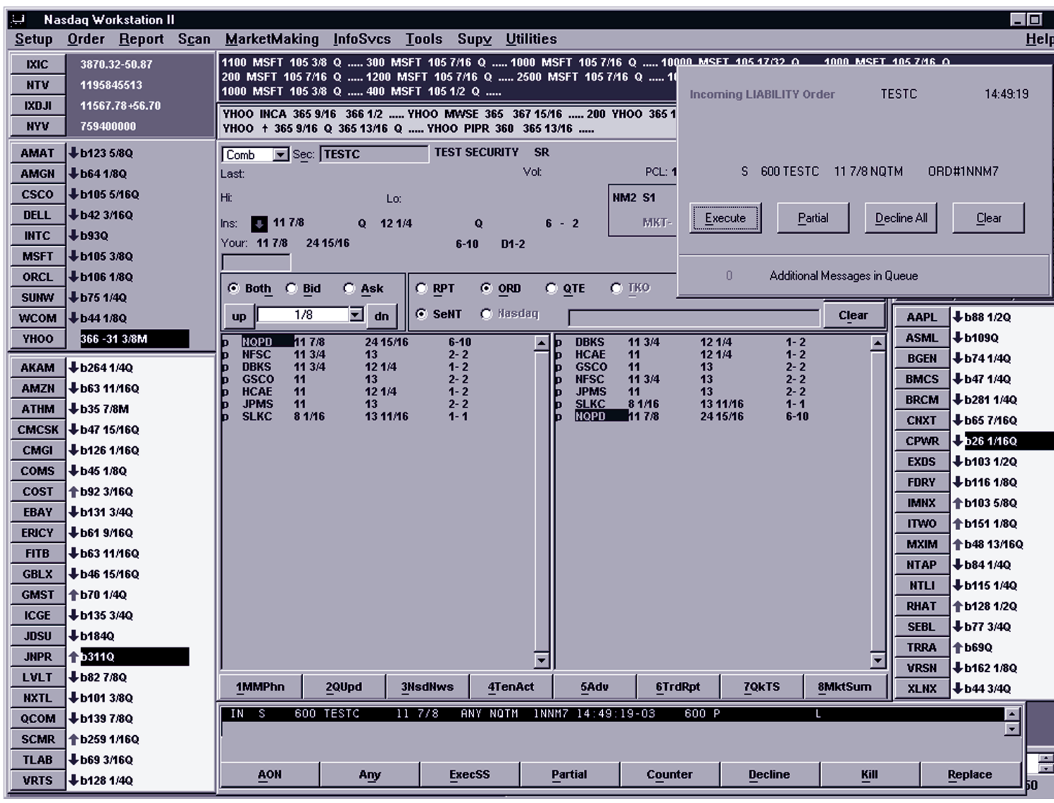
A market participant may not cancel or attempt to cancel a SelectNet order for 10 seconds after the order is entered into the system. This rule applies to orders entered during all three sessions of the SelectNet operational hours (9:00 to 9:30 a.m., ET; 9:30 a.m. to 4:00 p.m., ET; and 4:00 to 5:15 p.m., ET).

SelectNet Liability Orders

You can elect to have an alert window appear on your Nasdaq Workstation screen when an incoming liability order that may be immediately executable under a Market Maker's firm quote obligation is received.

This **Incoming Liability Order** pop-up window does not affect the availability of all other workstation functions. If you want to access another window while the pop-up window is displayed, the pop-up window will move behind the active window. If another liability order is received while the pop-up is in the background, the pop-up window will reappear and display a new alert.

Incoming Liability Order Pop-Up Window



[Nasdaq Workstation II Screen]

It is possible for you to receive more than one incoming liability order notice at a time. There is a section on the pop-up window, "Additional Messages in Queue," that alerts you to the number of additional notices pending. You can respond to the orders by clicking on buttons at the bottom of the pop-up window. Each time you respond to the pop-up window, the "Additional Messages in Queue" number is reduced by one.

The Incoming Liability Order pop-up window will disappear when the liability order is either executed or times out. If there are multiple liability warnings in the window, and one of the orders is executed or times out, the "Additional Messages in Queue" number is reduced by one.

Backing Away

A "backing-away" occurs when a member firm is not complying with its obligations under Rule 11Ac1-1(c) (SEC Firm Quote Rule), which requires a Market Maker to execute an order "presented" to it at a price at least as favorable as its published quotation, up to its published quotation size. As a Market Maker, your obligation to fill an order begins at the time the order is "presented" regardless of how the order is transmitted to you. This includes an order presented to you through SelectNet. Backing away may also violate Conduct Rule 3320 and Marketplace Rule 4613(b), which require a Market Maker to trade at its quotation and up to its quotation size when presented with an order.

Exceptions to the Firm Quote Rule exist for Market Makers only if: (1) you revise your quoted price or size in Nasdaq prior to the order being presented; or (2) you have effected or are in the process of effecting a transaction at the time an order is presented and immediately upon completion of that transaction communicate a revised quotation to Nasdaq (the trade-ahead exception).

Regulatory Guidelines Concerning Backing Away

You should carefully read the applicable sections of the SEC Section 21(a) Report, which contain a discussion of a Market Maker's obligations under Rule 11Ac1-1, as well as specific situations that the SEC considers a violation of the rule. Following are some guidelines that you should be aware of:

(1) **Cancellation of preferenced SelectNet liability orders.** The fact that a preferenced SelectNet order is canceled by the order-entry firm before the three-minute time period expires does not eliminate the firm's firm-quote obligation with respect to that order while it was "live." Patterns of delay in filling liability orders may indicate non-compliance with Rule 11Ac1-1. If you are a Market Maker, your obligation to fill an order begins when the order is presented, not at the expiration of the three-minute time period.

(2) **Failure to act on a preferenced SelectNet liability order.** The fact that preferenced SelectNet liability orders may have scrolled off the Nasdaq Workstation screen is not an exception to Rule 11Ac1-1. If you are a Market Maker, you should take whatever steps you deem necessary to ensure that your preferenced liability orders received through SelectNet are monitored and responded to immediately.

(3) **No trade-ahead exception for SOES executions received after a preferenced SelectNet liability order.** A trade-ahead exception will not be permitted for SOES executions received after presentment of a preferenced SelectNet liability order. As stated in the SEC's 21(a) Report, "[b]ecause SOES executions are automatic and instantaneous, a Market Maker could not have been in the process of executing a SOES order that was received after a SelectNet order."

(4) **No automatic trade-ahead exception for quote changes.** A trade-ahead exception for trades that are reported after the presentment of a liability order will not be permitted if you, as a Market Maker, executed a trade and changed your quote without proof (such as the time of order entry) that you were in the process of executing the order prior to presentment of the preferenced SelectNet liability order, and you immediately updated your quote subsequent to the execution.

(5) **Late quote update.** A quote update that does not have an accompanying trade report must occur prior to, or simultaneously with, the presentment of a SelectNet liability order to be considered an exception to the Firm Quote Rule.

(6) **System problems, extreme weather, numerous SelectNet liability orders.** Situations such as system problems at your firm, extreme weather conditions, or receipt of numerous SelectNet orders surrounding a preferenced SelectNet order at your quotation, may be viewed as mitigating factors, but not exceptions to Rule 11Ac1-1.

On July 16, 1997, the SEC sent a letter to the NASD and NASD Regulation, Inc., providing guidance on a variety of firm-quote compliance issues. Based on the guidance provided in the SEC's letter, NASD Regulation℠ will continue to analyze the SOES/SelectNet "double-hit" issue on a facts-and-circumstances basis and will continue to review firms that demonstrate a pattern of non-responsiveness to SelectNet liability orders after presentment, and initiate disciplinary action, if warranted. As stated in the SEC's 21(a) Report, "the firm quote rule is triggered when an order is 'presented' to the Market Maker. Because all preferenced SelectNet orders are delivered electronically to a particular Market Maker, the presentment of an order is readily ascertainable."

Processing Backing Away Complaints

NASD Regulation has instituted procedures to address complaints immediately during the trading day. Backing-away complaints should be brought to the attention of the Market Regulation Department within five minutes of the alleged backing-away by calling (800) 925-8156. If you do not contact Market Regulation within five minutes, it will be difficult to obtain a contemporaneous trade execution from the Market Maker.

Your other option is to contact the other firm to seek resolution of the trade. If you contact the other side first, you will not be held to the five-minute requirement of contacting the Market Regulation Department. However, you must contact the other side within five minutes, and if there is no resolution, you must contact the Market Regulation Department immediately after your contact with the other firm.

Although Market Regulation will review and investigate complaints received by telephone or fax after the five-minute period, Market Regulation generally will not be able to assist in obtaining a contemporaneous trade execution for those complaints. Failure on the part of the complaining firm to contact the other Market Maker or Market Regulation within five minutes of the alleged backing away is not a defense for the potential violator to the backing away violation.

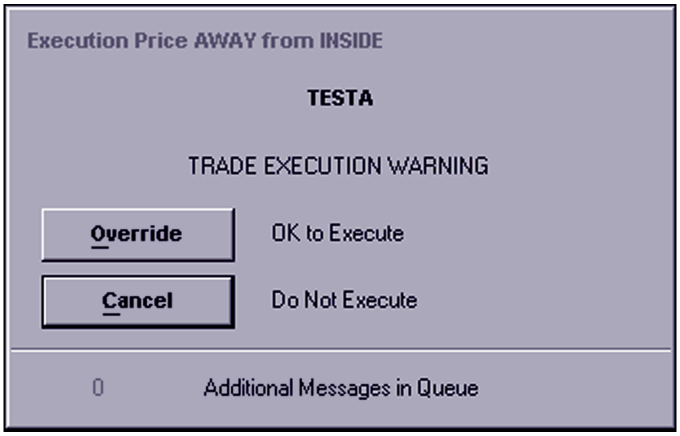
NASD Regulation will not pursue disciplinary action for backing-away complaints in which a contemporaneous trade execution is obtained or offered. However, it will keep a record of such incidents to determine if a firm has demonstrated a pattern of non-compliance with the Firm Quote Rule. Market Regulation will investigate individual instances of backing away and consider disciplinary action if it believes that a contemporaneous execution is warranted, but the Market Maker refuses to provide the “fill” upon request.

Short Sale Orders in SelectNet

Currently, SelectNet does not allow the entry of sell orders as “short sale exempt.” Until SelectNet can be modified, firms effecting short sale exempt orders through SelectNet should mark those orders as “short sales.” You can also use ACT to modify your SelectNet report to change it to short sale exempt.

Executions at a Price Away From the Current Inside Market Price

A SelectNet order can be executed away from the current inside; however, the Workstation will first display an “Execution Price Away from Inside” pop-up warning window. This pop-up window freezes the workstation until an action is taken. There are two options that are available from this pop-up warning window: (1) the execution request may be canceled, the pop-up window will disappear, and the order will remain open for further action; or (2) the price override may be selected, the order will be executed, and the pop-up window will disappear.



[Execution Price Away From Inside Pop-Up Window]

Fees for SelectNet

In the first quarter of 1998, Nasdaq instituted a fee adjustment for SelectNet, so that the fee for broadcast orders is $2.50 per side of execution, and the fee for directed orders is $1.00 per execution, order-entry side only. In October 1999, Nasdaq instituted a pilot pricing program that gives a volume discount for firms executing in excess of 50,001 directed SelectNet orders in a given month. There is a $0.25 charge for the cancellation of an unexecuted SelectNet order. Orders that time out are not considered cancellations for purposes of this cancellation fee, and therefore, no fee is assessed.

The fees listed above are temporary and subject to change. The most up-to-date fees for SelectNet are available in the "Trading Services" section on the Nasdaq Trader Web site at *www.nasdaqtrader.com*, or by calling Nasdaq Subscriber Services at (800) 777-5606.

The SEC has stated that ECNs/ATSs may charge non-customers for executions occurring through SelectNet. Individual ECNs/ATSs have established charges and any questions regarding these fees should be addressed to the ECNs/ATSs.

Phone Numbers

Nasdaq Product Development	(212) 858-4322
MarketWatch	
Trade Reporting Rules, Complaints	(800) 211-4953
StockWatch Section (Trading Halts)	(800) 537-3929
Firm Quote Compliance, Market Regulation	(800) 925-8156

Trade Reporting

Classes of Securities Subject to Trade Reporting

Nasdaq National Market®—The top tier of Nasdaq® issues that satisfy the highest level of listing qualifications on The Nasdaq Stock Market®.

The Nasdaq SmallCap Market℠—The second tier of Nasdaq issues, generally comprising companies with fewer assets than those on the Nasdaq National Market.

OTC Bulletin Board® (OTCBB)—An electronic screen-based market for issues that are not listed on Nasdaq or a U.S. Exchange. Unless there is an exemption, participating Market Makers must comply with the requirements of Securities and Exchange Commission (SEC) Rule 15c2-11 when quoting these issues.

Pink Sheets—Non-electronic, non-listed, and non-OTCBB securities, also subject to trade reporting rules.

Convertible Debt—A convertible bond listed on Nasdaq.

CQS—The Consolidated Quotation Service that allows Nasdaq Market Makers to quote exchange-listed securities off the floors of the exchanges. Transactions in exchange-listed securities are subject to trade reporting rules.

Transactions to be Reported

You must report all round- and mixed-lot transactions in Nasdaq, OTCBB, Pink Sheets, and CQS securities within 90 seconds of execution, except for automatically reported transactions executed through:

- Computer Assisted Execution System℠ (CAES℠);
- SelectNet®; and
- Small Order Execution System℠ (SOES℠).

Below is a chart describing which transactions you are required to report as a National Association of Security Dealers, Inc. (NASD®) member:

		Contra Party			
Member	Transaction	Market Maker	Non-Market Maker	Customer	Exchange
Principal Transactions					
Market Maker	buys from:	No	Yes	Yes	No
	sells to:	Yes	Yes	Yes	No
Non-Market Maker	buys from:	No	No	Yes	No
	sells to:	No	Yes	Yes	No
Agency Transactions					
Market Maker	buys, as agent for customer, from:	No	Yes	Yes	No
	sells, as agent for customer, to:	Yes	Yes	Yes	No
Non-Market Maker	buys, as agent for customer, from:	No	No	Yes	No
	sells, as agent for customer, to:	No	Yes	Yes	No
Riskless Transactions by Non-Market Makers					
Non-Market Makers	buys from customer and sells to:	No	Yes	Yes	No
	sells to customer and buys from:	No	No	Yes	No

The following is a list of transactions that you are not required to report:

(1) Odd-lot transactions.

(2) Transactions that are part of a primary distribution by an issuer or of a registered secondary distribution (other than "shelf distributions"), or of an unregistered secondary distribution.

(3) Transactions made in reliance on Section 4(2) of the Securities Act of 1933.

(4) Transactions where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security (for example, to enable the seller to make a gift).

(5) Purchases or sales of securities effected upon the exercise of an option pursuant to the terms of the option, or the exercise of any other right-to-acquire securities at a pre-established consideration unrelated to the current market.

(6) The acquisition of securities by a member as principal, in anticipation of making an immediate distribution or offering on an exchange.

(7) Purchases of securities off the floor of an exchange, pursuant to a tender offer.

Who Reports the Transaction

Transactions Between	Who Reports
Two Market Makers	Sell-side only
A Market Maker and non-Market Maker	Market Maker only
Two non-Market Makers	Sell-side only
A member and a customer or a non-member	The member
An NASD member firm and a national securities exchange	Only the exchange

What Price Should Be Reported

The member reports the number of shares and the price excluding any markup, markdown, commission, or service fee. For example:

Who/What	Reports
Buy as principal 100 shares at 40 plus 1/8 markup	Buy of 100 shares at 40
Sell as agent 100 shares at 40 plus $12.50 commission	Sell of 100 shares at 40
Buy as agent 100 shares at 40 plus $12.50 commission *and* Sell as agent 100 shares at 40 plus $12.50 commission	Cross of 100 shares at 40

Note: No average prices should be reported to the tape.

Trade Reporting Based on Execution Time

For Nasdaq National Market, The Nasdaq SmallCap Market, Convertible Bonds, and domestic OTC equities (including Canadian Issues and American Depositary Receipts [ADRs]):

If the trade was executed between	Report
Midnight – 8:00 a.m., Eastern Time (ET)	Between 8:00 and 9:30 a.m., ET: enter .T modifier and include execution time.
8:00 – 9:30 a.m., ET	Enter .T modifier and include execution time, if not reported within 90 seconds.
9:30 a.m. – 4:00 p.m., ET	90-second trade reporting required through ACT.
4:00 – 5:15 p.m., ET	Enter .T modifier and include execution time, if not reported within 90 seconds.
5:15 p.m. – midnight, ET	On T+1 between 8:00 a.m. and 5:15 p.m., ET: enter execution time and designate “as/of.”

For foreign OTC equities (excluding Canadian Issues and ADRs)[1]:

If the trade was executed	Report
Any time on trade date	On T+1 between 8:00 a.m. and 1:30 p.m., ET: enter execution time and designate “as of.”

[1]Member firms that have the operational capability to report transactions in foreign securities (excluding Canadian Issues and ADRs) within 90 seconds of execution, between the hours of 8 a.m. and 5:15 p.m., ET, may do so at their option.

For CQS Securities:

If the trade was executed between	Report
Midnight – 9:30 a.m., ET	On T+1 between 8:00 a.m. and 5:15 p.m., ET: enter execution time and designate “as of.”
9:30 a.m. – 4:00 p.m., ET	90-second trade reporting required through ACT.
6:30 p.m. – midnight, ET	On T+1 between 8 a.m. and 5:15 p.m., ET: enter execution time and designate “as of.”

ACT Trade-Reporting Modifiers

.B Bunched Trade—Aggregated/bunched transaction reported within 90 seconds. Bunching is permitted for Nasdaq National Market and SmallCap Market issues, if all of the following conditions are met:

- All orders to be bunched must be executed within 60 seconds of initial execution and effected at the same price.
- All executions must be reported within 90 seconds of the initial executions.
- The individual transactions to be aggregated must involve orders of fewer than 10,000 shares each (exception: the first day of secondary market trading following an IPO).
- The tickets must indicate that the transaction was bunched for trade reporting.

.C Cash Trade—Cash transaction reported within 90 seconds.

.ND Next Day—Next day settlement transaction reported within 90 seconds.

.O Price Override—Transaction entered within 90 seconds of execution, but its price rejects because the market has moved. Enter .O, widen the price parameter, and complete the report.

.PRP Prior Reference Price—Transaction report that reflects a price different from the current market when the execution is based on a prior reference point in time, which shall be accompanied by the prior reference time.

.SB Late Bunched Trade—Aggregated/bunched transaction reported more than 90 seconds after the initial transaction. See bunched trade (.B) rules on the previous page.

.SLD Late Trade—Transaction executed during normal market hours (9:30 a.m. - 4:00 p.m., ET), but reported more than 90 seconds after execution. Nasdaq trades executed before 4:00 p.m., but reported after 4:00 p.m., may be reported with an .SLD modifier until 4:39 p.m., ET. CQS trades may be reported with an .SLD modifier until 5:15 p.m., ET. All .SLD trade reports must include the time of execution.

.SNN Extended Extended Settlement Trade—Transaction with a settlement date between two and 60 days away. Report .S and indicate the appropriate number of business days in which the trade will settle. For example: .S08 for eight days.

.T Pre-Opening Or After Hours Trade—Nasdaq transaction executed outside normal market hours.

.W Weighted Average—Nasdaq or CQS transaction executed on a weighted basis.

Riskless Principal Transactions

A riskless principal transaction is:

(1) one in which a member that is not a Market Maker in the security, after receiving a customer's order to buy, purchases the security as principal from another member or customer to satisfy the order to buy, or

(2) after receiving a customer's order to sell, the member sells the security as principal to another member or customer to satisfy the sell.

The trade will be reported as one transaction, the same as an agency transaction, excluding the markup or markdown, commission equivalent or other fee. A riskless principal transaction in which a member purchases or sells the shares on an exchange to satisfy a customer's order, will be reported by the exchange and not by the member. The selling Market Maker will be responsible for reporting the trade in transactions between two Market Makers.

Paper Form T

Now that the Automated Confirmation Transaction Service℠(ACT℠) window is open for up to one year from trade date, it is no longer permissible to report trades beyond T+1 by using a paper Form T, subject to certain limited exceptions.

Trade Corrections

The Browse function in ACT, accessible through the "Utilities" menu located on the main menu bar of Nasdaq Workstation II®, is used for trade scanning and reconciliation of original T and T+n open and as-of trades. The Browse function can be used by both order-entry firms and Market Makers. The Browse function is used to:

(1) view trades entered into the system;

(2) accept, decline, cancel, or error open trades;

(3) break a matched or accepted trade; or

(4) change an entry from "principal" to "agent" or "riskless," or change it from "agent" to "principal" or "riskless."

Phone Numbers

MarketWatch

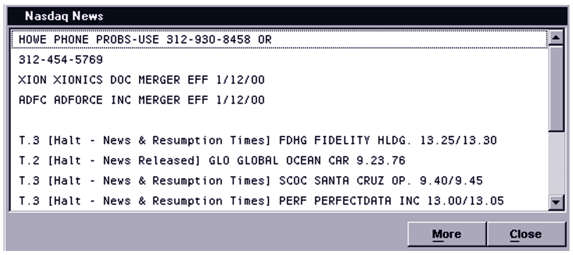
Trade Reporting Rules, Complaints	(800) 211-4953
StockWatch Section (Trading Halts)	(800) 537-3929

Trading Halts

The Nasdaq Stock Market® provides real-time surveillance of issuer activity on Nasdaq® by reviewing press releases issued by Nasdaq-listed companies for material news, and by monitoring price and volume activity in Nasdaq securities using automated surveillance systems. In the course of on-line surveillance, the Nasdaq StockWatch Department has the authority to implement temporary trading halts to allow for even dissemination of material news.

Once a temporary trading halt has been implemented, StockWatch promptly notifies the news wires and all markets where the Nasdaq stock or derivative may be listed. As a member of the National Association of Securities Dealers, Inc. (NASD®), you may not trade during the trading halt. StockWatch updates the status of the trading halts on the Nasdaq News frame, located under the "InfoSvcs" menu, on Nasdaq Workstation II® (NWII™). If a market participant pulls up that stock's symbol during a halt, the interactive area will not display any quotes and will indicate that the security has been held.

Tracking the status of trading halts can also be done by accessing the Nasdaq News frame. The schedule listed on the following page identifies the specific codes that reflect the status of trading halts, suspensions, and cease trade orders in Nasdaq and Consolidated Quotation System (CQS) securities.



Nasdaq News

HOWE PHONE PROBS-USE 312-930-8458 OR
312-454-5769
XION XIONICS DOC MERGER EFF 1/12/00
ADFC ADFORCE INC MERGER EFF 1/12/00

T.3 [Halt - News & Resumption Times] FDHG FIDELITY HLDG. 13.25/13.30
T.2 [Halt - News Released] GLO GLOBAL OCEAN CAR 9.23.76
T.3 [Halt - News & Resumption Times] SCOC SANTA CRUZ OP. 9.40/9.45
T.3 [Halt - News & Resumption Times] PERF PERFECTDATA INC 13.00/13.05

More Close

[Nasdaq News Frame]

Another source for tracking trading halts is on the Nasdaq Trader℠ website, nasdaqtrader.com. From the homepage, simply click on the "Trading Halts" shortcut button. You can access a list of trading halts and resumptions for the current day, a display of halted issues that have not resumed trading from previous days, an archive of trading halts, and trading halt codes.

NASDAQ TRADER
the premier site for Nasdaq trading information
Home | Amex Trader Home | Site Search | Symbol Directory | FAQs | Glossary
TRADING SERVICES | MARKET DATA SERVICES | TRADING DATA | SECURE DATA | TRADER NEWS

CURRENT TRADING HALTS
TRADING HALT HISTORY
TRADING HALT SEARCH
TRADING HALT CODES
CIRCUIT BREAKERS
TRADER MANUAL
STOCKWATCH
TRADEWATCH

Trading Halts

as of Wednesday, January 12, 2000

Halt Date	Halt Time	Issue Symbol	Issue Name	Reason Code	Resumption Date	Resumption Quote Time	Resumption Trade Time
1/12/2000	09:53:32	RAD	RITE AID CP	T3	1/12/2000	11:19:70	11:19:70
1/12/2000	09:23:76	GLO	GLOBAL OCEAN CARRIER	T2			
1/12/2000	08:49:97	SYBB	SYNSORB Biotech Inc	T3	1/12/2000	09:55:00	10:00:00
1/12/2000	08:48:76	SCOC	The Santa Cruz Operation	T3	1/12/2000	09:40:00	09:45:00
1/12/2000	08:48:17	PRRC	Precision Response Corporation	T3	1/12/2000	09:40:00	09:45:00
1/12/2000	08:30:00	LCBM	Lifecore Biomedical Inc	T1			
1/11/2000	16:33:95	NVB	INCO LTD CLVBN SHRS	T3	1/12/2000	09:13:32	09:13:32
1/11/2000	15:44:37	TIWI	Telesystem Intl Wireless Inc	T3	1/12/2000	09:00:00	09:00:00
1/7/2000	16:55:98	APM	APPLIED MAGNETICS CP	T2			
1/7/2000	11:29:93	FDHG	Fidelity Holdings Inc	T2			
12/29/1999	11:15:96	GTOSQ	Gantos Inc	T1/T12			
12/28/1999	10:39:52	KCS	K C S ENERGY INC	T2			
12/27/1999	09:40:38	XCL	X C L LTD NEW	T1			
12/22/1999	09:42:87	PFC	PMCC FINANCIAL CP	T2			
12/22/1999	08:55:02	NHMC	National Healthcare	T1/T12			
12/17/1999	09:26:15	OLAB	OraLabs Hldg Corp	T1/T12			
11/29/1999	17:04:81	STYLE	Styling Technology Corporation	T1/T12			
11/17/1999	08:51:69	ACLYE	Accelr8 Technology Corporation	T1/T12			
11/8/1999	10:14:43	SRY	SURETY CAPITAL CP	T2			
10/15/1999	16:08:89	LVEN	Las Vegas Entertainment Netwk	T1/T12			
9/16/1999	14:19:02	DDN	DYNAMEX INC	T2			
8/24/1999	09:40:07	ITR	INTEG TRANS NTWK GRP	T2			
6/22/1999	08:42:41	GTCMY	Great Central Mines NL ADR	H11			
5/26/1999	09:42:01	IAM	ALTOS HORNOS DE MEX	T2			

[MarketWatch Page]

Code Explanation

T.1 [Halt-News Pending] company symbol, name, and halt time. Trading is halted pending release of material news.

T.2 [Halt-News Released] company symbol, name, and halt time. The news has begun the dissemination process over a major wire service.

T.3 [Halt-News and Resumption Times] company symbol, name, and resumption time. The news has been fully disseminated over a major wire service. Two times will be displayed: (1) the time when Market Makers can enter quotations, followed by (2) the time the security will be released for trading. This is referred to as the five-minute window. For example, the Nasdaq News frame would display:

T.3 ABCD AB Company 12.05/12.10

T.1/T.12 [Halt-Additional Information Requested by Nasdaq] company symbol, name, and halt date. Trading is halted pending receipt of additional information requested by Nasdaq.

H.4 [Halt-Non-compliance] company symbol, name, and time of update. Trading is halted due to the company's non-compliance with Nasdaq listing requirements.

H.9 [Halt-Not Current] company symbol, name, and time of update. Trading is halted because the company is not current in its required filings.

H.10 [Halt-SEC Trading Suspension] company symbol, name, date/time of suspension; date/time suspension expires. The Securities and Exchange Commission (SEC) has suspended trading in this stock.

H.11 [Halt-Regulatory Suspension/Cease Trade Order] company symbol, name, date/time. Trading is halted in conjunction with a foreign securities exchange or market for regulatory reasons.

When a trading halt has occurred in a CQS security, only the official resumption time will be displayed under the T.3 status. There is no five-minute interval to update quotes during CQS trading halts. Although trading halts may vary in length, trading is normally resumed 30 minutes following the full dissemination of the news over a major wire service.

Any trading during a halt is a violation of NASD Conduct Rule 3340. Any trades executed during a halt must be canceled as soon as possible before the close of the trading day. If not, Nasdaq will cancel the trade.

Nasdaq will suspend trading in conjunction with all suspensions by the SEC, regulatory suspensions, and Cease Trade Orders (CTOs) from other regulators. When a trading halt has been implemented as a result of an SEC suspension, the status of the halt is updated with an H.10 indication. A trading halt resulting from a CTO or regulatory suspension is updated with an H.11 indication. The date and time of the trading suspension, and the date and time the suspension expires, will be displayed on the news frame. For example, the Nasdaq News frame would display:

H.11 ABCD AB Company SEC Susp 7/20/00 9.30 am Exp 8/2/00 12.00 am

OTCBB Halts

Nasdaq will halt trading in OTC Bulletin Board®, (OTCBB) issues in the following instances:

- The OTCBB security is dually listed on a foreign market or is registered with a foreign regulatory authority and the foreign market or regulatory authority has imposed its halt because of potential fraudulent conduct or other public interest concerns. Nasdaq will not impose a halt if the foreign entity's halt is based on the dissemination of material news, an issuer's failure to meet regulatory filing requirements imposed by a foreign market or regulatory authority, or for operational reasons (e.g., order imbalance in the foreign market).
- The OTCBB security is a derivative or component of a Nasdaq or exchange-listed security and Nasdaq or the exchange halts trading in the underlying security.

- Failure to comply with SEC Rule 10b-17 - The OTCBB issuer does not timely provide the NASD with information required by SEC Rule 10b-17 regarding untimely announcements of record dates.

Another source for tracking OTCBB trading halts is on the OTCBB website, *www.otcbb.com*. From the homepage, simply click on the "Trading Halts" shortcut button. You can access a list of trading halts and resumptions for the current day, a display of halted issues that have not resumed trading from previous days, an archive of trading halts, and trading halt codes.

Emergency Market Conditions: Circuit Breaker Halts

When extraordinary market movements cause a market-wide drop in stock prices, Nasdaq will halt all trading in Nasdaq-listed and exchange-listed securities by NASD member firms. This is referred to as a "circuit breaker halt."

Currently, when the Dow Jones Industrial Average (DJIA) declines by levels of 10 percent, 20 percent, and 30 percent, circuit breaker trigger points are hit. The actual numerical points are determined each calendar quarter (based on the DJIA average for the final month of the quarter).

For current circuit breakers please consult the circuit breakers web page on the Nasdaq Trader website at nasdaqtrader.com.

The halt is accomplished by a market-wide halt signal, indicated on NWII as an "h" next to the inside quote display. This indicator is also disseminated to quotation vendors. Nasdaq will also disseminate a pop-up window on the workstation with the time of the halt and the scheduled resumption time. When trading is halted, the Automated Confirmation Transaction Service℠ (ACT℠) will remain open to accept trade reports, but members must not continue trading until after trading has officially resumed.

If the market closes for the day, trading in Nasdaq securities will recommence at 9:30 a.m., ET, the following business day, with pre-open trading allowed at 8:00 a.m., ET. During the circuit breaker trading halts, NASD member firms may not directly effect trades in Nasdaq- or exchange-listed securities on domestic or international markets for their own accounts, and may not solicit customer orders in these securities. Unsolicited customer orders, however, may be routed to a non-member for execution in a foreign market.

Phone Numbers

StockWatch	(800) 537-3929
Nasdaq Product Development	(212) 858-4322
Market Watch	
Trade Reporting Rules, Complaints	(800) 211-4953
StockWatch Section (Trading Halts)	(800) 537-3929
Firm Quote Compliance, Market Regulation	(800) 925-8156

Training

To arrange for training or to request training materials, please contact:
Nasdaq Subscriber Training (212) 858-4084

You may also complete the Subscriber Training request form located at the URL below.
http://nasdaqtrader.com/asp/GetCustomerInfo.asp?2
or send email to Subscribertraining@nasd.com

Limit Orders

Limit Orders

The National Association of Securities Dealers, Inc. (NASD®), Limit Order Protection Interpretation eliminated the so-called "Manning safe harbor" that previously allowed you, as a member firm, to trade ahead of your customers' limit orders if you disclosed to your customers that trading ahead was your firm's practice. Limit Order Protection Rules are sometimes referred to as Manning Rules.

Limit Order Interpretation

According to Rule IM-2110-2, a member firm cannot accept and hold a customer, or a member-to-member, limit order in a Nasdaq® security and continue to trade that security for its own market-making account at prices that would satisfy the customer's limit order. The interpretation requires that if you are holding a customer's limit order, you must execute that limit order, in full or in part, to the extent that your firm trades at the limit-order price, or at a price lower than a limit order to buy or higher than a limit order to sell. If you trade through a limit order that you have accepted, you must execute that limit order as quickly as possible, but within a general time parameter of one minute. This one-minute standard does not apply during unusual market conditions, which potentially could include openings, resumptions of trading after trading halts, and commencement of trading of an initial public offering (IPO), but you must execute such limit orders as soon as practicable under the circumstances.

A Market Maker is obligated to protect a limit order up to the size that it trades ahead of the order. For example, if your firm holds a customer's limit order to buy 500 shares of WXYZ at 20 1/4 and it purchases 200 shares of WXYZ at 20 1/8 in its market-making capacity, as a Market Maker you need only execute 200 shares of your customer's limit order. However, you only are required to protect a day-limit order during market hours.

Trades done in the Small Order Execution System℠ (SOES℠) and SelectNet® activate your responsibility to execute the limit orders you are protecting. Once you have agreed to accept preferenced orders through SOES from another member, you must also protect limit orders preferenced to you from that firm.

Keep in mind, the execution of a limit order pursuant to the interpretation does not trigger an obligation to execute another limit order on the opposite side of the market.

Scope of the Interpretation

All customer limit orders received by your firm—either from your own customers or from other broker/dealers (so called "member-to-member" orders)—are subject to the limit order interpretation. Member-to-member limit orders are defined as customer orders from another member firm, not proprietary orders. The interpretation applies to Nasdaq National Market® and The Nasdaq SmallCap Market℠ securities, and does not apply to odd-lot orders.

IM-2110-2 does not apply to a customer limit order if the limit order is marketable at the time that it is received by a Market Maker. Although these orders must be executed at their limit price or better, these orders are to be treated as market orders for the purposes of determining execution priority. The exclusion for marketable limit orders from the general application of IM-2110-2 is limited solely to customer limit orders that are marketable when received by a Market Maker. If a customer limit order is not marketable when received by a Market Maker, the limit order must be accorded the full protections of IM-2110-2. Moreover, if the limit order was marketable when received and then becomes non-marketable, it must, from that point in time until the order is executed, canceled or modified, be accorded the full protections of IM-2110-2.

The NASD does not impose any obligation upon you to accept or handle limit orders from any or all of your customers; however, by accepting customer limit orders, you then owe those customers your duties of "best execution," regardless of whether the orders are executed through your market-making capacity or sent to another member for execution. The interpretation is in effect during normal Nasdaq market hours, from 9:30 a.m. to 6:30 p.m., Eastern Time (ET). However, if a customer does not formally assent ("opt-in") to processing of their limit order(s) during the extended hours period, which commences after the normal close of Nasdaq at 4:00 p.m. and ends at 6:30 p.m. Eastern Time, limit order protection will not apply to that customer's order(s).

Terms and Conditions of Limit Orders

You may attach terms and conditions only to limit orders that are either for institutional accounts or for orders that are 10,000 shares or greater (unless those orders are less than $100,000 in value). Institutional accounts are defined as those held by:

- banks, savings and loan associations, insurance companies, or registered investment companies;
- investment advisers registered under Section 203 of the Investment Advisers Act of 1940; and
- any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million.

As the member firm imposing the terms and conditions on the limit order, you must ensure that those terms and conditions are clearly communicated to the customer. Any customer may place special conditions on the handling of a limit order, and although you may not seek to negotiate special terms and conditions with non-institutional customers, any customer may qualify or specify certain conditions regarding the handling of a limit order. For example, a customer placing a larger-sized limit order, such as 1,000 shares, may determine that he or she is best served if the limit order is handled as an "all-or-none" (AON) order, or is not subject to minimal partial fills as a Market Maker trades with smaller-sized market orders at the same or inferior price as the limit order. The interpretation does not prohibit a customer from voluntarily categorizing a limit order as "not held," which permits you to trade at any price without being required to execute the customer's order.

With adequate disclosure, you may impose commissions, fees, or separate charges for the handling of a limit order.

Price Improvement

As a Market Maker, you may give price improvement to an incoming orders. To avoid violating the limit order protection rule when giving price improvement to an incoming market order, the minimum amount of price improvement to the market order must be 1/16, or one-half of the normal minimum quote increment when the actual spread equals the minimum quote increment.

Priority of Execution

Your firm may choose any reasonable methodology for the way it executes the multiple limit orders it holds, as long as it applies the methodology consistently. You may not knowingly favor your own customers' limit orders in determining the priority of limit orders accepted by your firm from your own customers and customers of other members.

Protecting Customer Limit Orders at a Price

When your firm accepts limit orders from its retail customers that incorporate a commission, commission-equivalent, markup, or markdown in the limit-order price (collectively referred to as remuneration), you must protect the limit orders at your "stated" limit-order price, which includes the remuneration.

For example, if your customer enters a limit order to purchase security ABCD, with a request that the total costs not exceed $10 per share, and that customer is informed that the Market Maker charges a markup of 1/4, the customer order would be deemed a limit order at 9 3/4. The Securities and Exchange Commission (SEC) emphasizes that “the price at which the limit order is to be protected must be clearly explained to the customer.”

As a further example, assume that the inside market is 10 – 10 1/2. A customer places an order with your firm to buy 500 shares and states that he or she wants to trade “net,” with total transaction costs not to exceed 10 3/4. Your firm must inform its customer of the specific price at which it will protect that order.

If your firm informs a customer that it will protect an order at a price, it must report the trade at that price. Firms that choose to use an internal sales credit as a part of their calculation in determining the price for limit order protection purposes have therefore chosen to make the sales credit part of the markup. Once you have effected the markup calculation in this way, your firm must be consistent in using the same calculation for other rules related to execution price reports. Thus, your firm must treat the internal sales credit as part of the markup for trade reporting and confirmation purposes.

Keep in mind, your firm may always provide the customer an execution at a more favorable price.

Limit Order Display Rule

SEC Rule 11Ac1-4 (Display Rule) requires Market Makers to display in their quotes the price and full size of customer limit orders. The rule requires you, as a Market Maker, to display customer limit orders that are priced better than your quote or that add to the size associated with your quote when you are at the best price in the market.

If, however, your customer’s limit order is a de minimis size — that is, less than or equal to 10 percent of your displayed quote size — you do not have to update your quote to reflect the size of the limit order. The Display Rule requires that you, as a Market Maker, update your quote to reflect your customer’s limit order as soon as practicable, but no later than 30 seconds of receiving the order. The

30-Second Rule does not apply at market opening or shortly thereafter, when trading re-opens after a trading halt, or when an IPO first begins trading. During these periods, you must display customer limit orders as soon as practicable under the circumstances. Anytime you are at the inside or the inside market moves to your quote, your displayed price and size must reflect the aggregated size of all of your customers' limit orders.

The eight exceptions to the Display Rule requirements are:

- customer limit orders executed upon receipt;
- customers who request that the limit order not be displayed;
- odd-lot orders;
- block-sized orders (10,000 shares or greater or market value of at least $200,000), unless the customer requests that the order be displayed;
- limit orders displayed immediately in a Nasdaq or exchange system;
- limit orders delivered immediately to an electronic communications network (ECN)/alternative trading system (ATS) that complies with the provision of the quote rule called the ECN/ATS Display Alternative;
- customer limit orders delivered to another firm that complies with the display rule for those orders; and
- all-or-none limit orders.

SEC Discussion of Best Execution and Protection of Limit Orders

The SEC reiterates a broker/dealer's obligation to provide best execution to its customers. When you hold a limit order priced better than your quote, and you subsequently receive a market order on the opposite side of the market, it is no longer appropriate for you to execute the market order at your quote price and subsequently execute the limit order. The market order must receive the benefit of the better limit order price. For more information, see "Best Execution Requirements" in Chapter 12.

ECN/ATS Rules Regarding Limit Orders

The limit order protection obligations apply to all customer limit orders sent to an ECN/ATS, an unlisted trading privileges (UTP) participant, or a Market Maker, and the member sending or receiving the order cannot trade ahead of that order. Therefore, your obligation to protect a customer limit order does not cease when you send the order to one of these execution venues. You must monitor the status of the limit order and not trade ahead of it until the order has been executed.

For example, if you receive a customer limit order and send it to an ECN/ATS for execution, and subsequently you receive a market order, the SEC has stated that the market order must be given the improved price of the limit order. Your obligation to protect the limit order and to improve the price of an incoming market order does not end when the limit order is sent to another entity for execution.

Phone Numbers

NASD Regulation®, Market Regulation	(800) 925-8156
Nasdaq Office of General Counsel	(202) 728-8294

Clearly Erroneous Trades

The National Association of Securities Dealers, Inc. (NASD®) has the authority, under Rule 11890, to cancel or adjust trades executed through the use of the Nasdaq® systems if those trades are "clearly erroneous." The following section explains how member firms can use the procedures for clearly erroneous trades.

The Erroneous Transaction Rule (Rule 11890 of the Uniform Practice Code) says that:

> *"Officers of The Nasdaq Stock Market… have the authority to review any transaction arising out of the operation of any automated quotation, execution, or communication system owned or operated by Nasdaq… with a view toward maintaining a fair and orderly market and the protection of investors and the public interest."*

Accordingly, if you entered or executed a trade that is clearly in error in the Small Order Execution System℠ (SOES℠), SelectNet®, or another Nasdaq system, there is a procedure for timely review by a designated Nasdaq officer and cancellation of the trade or adjustment of its terms if it is ruled erroneous.

Under the rule, there must be an obvious error in the terms of the trade, such as price, number of shares, the identity of the security, etc. For example, if you entered an order into SelectNet to buy a stock at 10, but you entered the order for 100 erroneously, you would be able to request a ruling on the grounds that the price was clearly in error.

Procedure to Cancel Trades

If you execute a trade in error, fax your written request to cancel the trade to Nasdaq Market Operations at (203) 385-6384. It does not have to be a typed letter; it can be handwritten, but it must be received by Nasdaq Market

Operations within the time frames specified in Rule 11890. Upon receipt of your fax, you will have an additional half-hour to provide any substantiating information.

An erroneous complaint should identify the security, shares, price, and contra broker as well as the Nasdaq system through which the transaction was executed. In the case of SelectNet transactions, you may identify the transactions by providing the SelectNet reference numbers. Nasdaq may reject a request if the transaction cannot be readily identified from the filed complaint. Also, your initial request or follow up documentation should explain the nature of the error.

Nasdaq Market Operations will contact the contra party to the trade and offer them the option of faxing any facts they feel are relevant.

The details of the transaction and related market activity will be presented to a Nasdaq officer for consideration, along with the letter from your firm and the contra party.

The officer has three options: (1) the officer may declare the trade “null and void”; (2) the officer may modify one or more terms of the transaction; or (3) the officer may decline to act on the request.

Nasdaq Market Operations staff will call both parties to the transaction and advise them of the ruling. In addition, the officer will fax a written notice of the ruling to both parties.

Complaint Time Frame

To request a review, Nasdaq Market Operations must receive your written or faxed request within the following time frames:

- For transactions occurring between 9:30 a.m. and 10:00 a.m., Eastern Time (ET), your written request must be received by 10:30 a.m., ET.
- For transactions occurring prior to 9:30 a.m. or after 10:00 a.m., ET, your written request must be received within 30 minutes of the transaction.

If the officer's determination is to adjust the terms of the trade or to declare your transaction to be erroneous, Nasdaq will cancel the transaction or adjust its terms through its systems; no further action is required on your part.

The officer's determination will be communicated verbally. If either party to the transaction disagrees with the officer's decision, an appeal may be made to the Nasdaq Market Operations Review Committee. An appeal request must be received by Nasdaq Market Operations in writing or by fax within 30 minutes following verbal notification of the decision. If notification was made after 4:00 p.m., ET, either party has until 9:30 a.m., ET, the following business day to request an appeal.

Transaction Reviews Initiated by Nasdaq

In the event of a system malfunction, Nasdaq may declare transactions clearly erroneous and either cancel the transactions or modify their terms. An example of this might be a Nasdaq system error that generates trades at incorrect prices or submits them to the Automated Confirmation Transaction Service℠ (ACT℠) in error. Nasdaq has until 6 p.m., ET, on the day following the transaction to declare it erroneous, although the time frame can be extended due to extraordinary circumstance.

Transactions Executed Outside Regular Market Hours

NASD *Notice to Members 00-10* cautioned members to use prudence when entering or executing transactions prior to market open or after market close when markets tend to be less liquid. While you may have made a mistake in entering or executing a transaction, it may not be obvious that the transaction is erroneous. For that reason, traders should pay particular care to orders entered or executed outside of normal market hours, details of the order, and preventative overrides necessary to enter or execute such orders.

Questions and Answers

Q. If a trader meant to execute 100 shares through SelectNet, but traded 200 in error, would a ruling request be appropriate?

A. Although you can request a review, it may not be possible for the officer to determine that the transaction was, in actuality, an error. Despite the fact that you may have made a mistake, it is not an obvious error if the trade was consistent with the market price and size at the time of the transaction. If you executed 10,000 shares of a thinly traded stock, the transaction might be viewed as an obvious error, being inconsistent with the trading pattern of the issue.

Q. Can I ask for an erroneous trade ruling for a pre-opening SelectNet trade?

A. Yes: the rule makes no distinction as to the time of the transaction—only that you must file within the applicable timelines.

Q. Are executions done through an electronic communications network (ECN)/alternative trading system (ATS) covered by the erroneous transaction rule?

A. The rule is restricted to systems owned or operated by the NASD or its subsidiary corporations, such as Nasdaq. The rule covers transactions done through the Nasdaq system in SelectNet with authorized ECNs/ATSs. The rule does not apply to trades executed by an ECN/ATS outside of the Nasdaq system (e.g., orders transmitted directly to an ECN/ATS that is crossed internally by the ECN/ATS).

Q. Must I provide additional documentation that has been requested by the Nasdaq officer?

A. The rule requires that the member involved in the transaction shall provide Nasdaq with any information that it requests.

Q. What if I've changed my mind and no longer want to proceed with the erroneous transaction process?

A. Once your written request for an adjudication is received by Nasdaq, it cannot be withdrawn unless both parties to the transaction agree.

Q. How detailed must my filing be?

A. Initially you must clearly identify the transaction(s) at issue and request a determination. An additional 30 minutes is provided from the time your faxed request is received for you to provide any additional information. It is strongly recommended that you provide an explanation of the circumstances surrounding the questioned transaction.

Q. I attempted to send a fax but it was not received by Nasdaq Market Operations on time.

A. Faxes must be received by Nasdaq Market Operations within the time parameters stipulated in the rule. If the fax is not received on time, Nasdaq has no jurisdiction regarding the disputed transaction.

Q. What recourse do I have if I didn't file in time?

A. A Member can pursue its right to file arbitration on the disputed transaction.

Phone Number

Nasdaq Market Operations	(800) 219-4861

Fax Number

Nasdaq Market Operations	(203) 385-6384

Revised January 2000

Short Sales

The NASD Short Sale Rule

National Association of Securities Dealers, Inc. (NASD®) Rule 3350, or NASD Short Sale Rule, was approved by the Securities and Exchange Commission (SEC) on a pilot basis through September 30, 2000.

In general, the rule prohibits NASD member firms from effecting short sales (for customer or proprietary accounts) in Nasdaq National Market® (NNM) securities at or below the current inside bid whenever that bid is lower than the previous inside bid. (This is called the "Bid Test," as opposed to the "Tick Test," which applies to exchange-listed securities under SEC Rule 10a-1, the SEC Short Sale Rule.)

The rule does not apply to securities traded on The Nasdaq SmallCap Market℠, securities traded through other Nasdaq®-operated services like the OTC Bulletin Board® (OTCBB). The rule is in effect during normal domestic market hours, from 9:30 a.m. to 4:00 p.m., Eastern Time (ET). Unless eligible for one of the rule's exemptions described below, to effect a "legal" short sale on a down bid, you must execute the sale: at a price at least 1/16 of a point above the current inside bid, if the inside spread is 1/16 of a point or greater; or at a price equal to or greater than the offer price if the inside spread is less than 1/16 point.

The Nasdaq Stock Market® calculates the inside bid and disseminates symbols to denote whether the current inside bid is an "up bid" or a "down bid." Specifically, an up bid is denoted by a green "up" arrow and a down bid is denoted by a red "down" arrow on Nasdaq Workstation II® (NWII™). If a security's symbol has a green up-arrow next to it, you can effect short sales in the security and not violate the rule (even if you do not qualify for a short-sale exemption).

Exemptions to the NASD Short Sale Rule

Under the Qualified Market Maker Exemption, all Market Makers registered in a particular security are deemed "qualified" and may effect short sales in that security on down bids, so long as the short-sale transaction is made in connection with bona fide market-making activity.[1]

The NASD Short Sale Rule also contains a number of other exemptions. Specifically, the rule has exemptions for registered warrant and options Market Makers that hedge warrant or options positions established pursuant to bona fide market-making activity. The rule incorporates exemptions contained in SEC Rule 10a-1—the SEC Short Sale Rule—applicable to exchange-listed securities. For a more complete discussion of these exemptions, please refer to *NASD Notice to Members (NTM) 94-68* and *NTM 94-83*.

Three interpretations (IMs) to the rule are contained in IM-3350, in the *NASD Manual*, immediately following the rule language. You should read the interpretations in IM-3350 carefully, as they contain information about what constitutes bona fide market-making activity; the definition of a "legal" short sale; and examples of what are considered to be manipulative acts and violations of the rule.

Short Sale Rule for Exchange-Listed Securities

The SEC Short Sale Rule (10a-1) governs short sales in exchange-listed securities and is known as the "Up-Tick Rule." The rule governs short sales and applies to any security registered on a national securities exchange, whether the trade is effected on the exchange, on a regional exchange via unlisted trading privileges (UTP), or in the third market. The Up-Tick Rule does not apply to Nasdaq-listed securities, but it does apply to third-market transactions in exchange-listed securities. It requires that short sales of exchange-listed securities be effected only at a price above the previous sale price or at a price

[1] Since the rule has been in effect, Nasdaq has used the current standard as well as two other standards to determine whether a dealer is "qualified" and eligible for the short-sale exemption for Market Makers. Nasdaq presently is developing a new test (for which it intends to seek SEC approval), under which only Market Makers that meet certain quantitative criteria will be designated as primary Market Makers and will qualify for this exemption.

equal to the previous sale price if the last sale at a different price was below the current prevailing price. Short sales in exchange-listed securities are subject to a number of exemptions, which are set out in SEC Rule 10a-1.

Determining Long and Short Positions

The definition of a "short sale" is contained in SEC Rule 3b-3, and also in NASD Rule 3350(k)(1). Under SEC Rule 3b-3 and NASD Rule 3350(k)(1), a sale is a short sale if a seller does not own the security or the seller consummates the sale by delivery of a security borrowed by, or for the account of, the seller.[2] To determine whether the seller is long or short in the security overall, the seller must net out all of its positions in the security. Thus, if you have a net short position in a security, any sale of the security would be considered a short sale.

For a full discussion of these issues, please refer to the following Nasdaq Head Trader Alerts: *Alert #1997-30* (March 13, 1997); *Alert #1997-32* (April 2, 1997); and *Alert #1997-38* (April 18, 1997), which are located on the Nasdaq Trader℠ Web site at *www.nasdaqtrader.com*. Also refer to *NTM 94-68* and *NTM 94-83*.

Trade Reporting/ACT Requirements

All members must designate on their Automated Confirmation Transaction Service℠ (ACT℠) reports whether a proprietary or customer trade is a long sale, a short sale, or an exempt short sale. Under revisions to NASD Rule 6130(d)(6) implemented in 1997, Market Makers that are exempt from the rule now must mark their ACT reports to denote when they have relied on a short-sale rule exemption, and thus must denote all short sales—both exempt and non-exempt—as short sales. Accordingly, if you effect a non-exempt short sale (e.g., a short sale during an up bid or a short sale at least 1/16 above a point on a

[2] A seller shall be deemed to own a security if: (1) the seller or the seller's agent has title to it; (2) the seller has purchased, or has entered into an unconditional contract, binding on both parties to purchase it, but has not yet received it; (3) the seller owns a security convertible into or exchangeable for it and has tendered such security for conversion or exchange; (4) the seller has an option to purchase or acquire it and has exercised such option; or (5) the seller has rights or warrants to subscribe to it and has exercised such rights or warrants.

down bid, assuming a spread of 1/16), you must mark your ACT report as a short sale. If you effect a short sale in reliance on an exemption to the rule, you must mark your ACT report as an exempt short sale.[3]

SOES/SelectNet Short Sales

As a general rule, if as a Market Maker you enter an order into a Nasdaq execution system or an execution system sponsored by another broker/dealer that reports the trade on your behalf (e.g., SelectNet®, an electronic communications network [ECN]/alternative trading system [ATS], or your firm's proprietary trading system), you will be deemed to be in compliance with ACT reporting requirements if the denotation on your ACT report is consistent with your position and the status of the inside bid at the time you entered the order, not at the time that the order was actually executed.

Trades executed through the Small Order Execution System℠ (SOES℠) against a Market Maker are not subject to the above ACT reporting requirements because SOES is mandatory for all Nasdaq National Market securities and Market Makers have no control over the timing of executions through SOES. For a full discussion of these issues, please refer to *Head Trader Alert #1997-34*.

Affirmative Determination Requirements

NASD Rule 3370 governs affirmative determination requirements for both long and short sales. In customer short sales, you must make an affirmative determination that you will receive delivery of the security from the customer or that you can borrow the security on behalf of your customer for delivery by settlement date. Similarly, for short sales effected in your proprietary account, you must make an affirmative determination that you can borrow the securities or otherwise provide for delivery of the securities by settlement date. The rule

[3] Market Makers can use the QuickReport function on the Dynamic Quote window of Nasdaq Workstation II to enter exempt short sales (marked as "SX") and non-exempt short sales (marked "SS").

sets out a number of recordkeeping and other requirements to demonstrate that the appropriate affirmative determination has been made.

Mandatory Close-Out for Short Sales

When a Nasdaq security is designated as a UPC 71 security (that is, if it has a clearing short position of 10,000 shares or greater and is equal to one-half of one percent of its total shares outstanding), NASD Rule 11830 (formerly UPC Section 71) requires that any short sale for a customer or for a member's own account be delivered no later than the tenth business day following the settlement date. If delivery is not made, the member must close out the sale (cover the short) for cash or guaranteed delivery.

Buy-Ins

When a buy-in for a Nasdaq security is sent to a clearing corporation on behalf of a customer who wants possession of his or her shares, the buy-in must be executed for cash or guaranteed delivery, if the clearing corporation cannot satisfy the share allocation.

Phone Numbers

Nasdaq Office of General Counsel	(202) 728-8294
Nasdaq Market Operations	(800) 219-4861

Revised February 2001

Alternative Trading Systems (ATSs)/Electronic Communications Networks (ECNs) and How These Systems Relate to the Securities and Exchange Commission's Order Handling Rules

Securities and Exchange Commission (SEC) Regulation ATS defines an ATS as any organization, association, person, group of persons, or system:

(1) that constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange, as such term is defined in the Securities Exchange Act of 1934; and

(2) that does not: (i) set rules governing the conduct of subscribers other than the conduct of such subscribers' trading on the ATS; or (ii) discipline subscribers other than by excluding them from trading on the ATS.

The most familiar type of ATS is an electronic communications network. SEC Rule 11Ac1-1(a)(8) (SEC Quote Rule) defines an electronic communications network (ECN) as:

> *"any electronic system that widely disseminates to third parties orders entered therein by an exchange Market Maker or OTC Market Maker, and permits such orders to be executed against in whole or in part . . ."*

The rule excludes electronic systems that cross orders at one or more specified times at a single price set by the system (by algorithm or by any derivative pricing mechanism) and do not allow orders to be crossed or executed directly by participants outside of those specified times.

The rule also excludes any system operated by a Market Maker that executes customer orders primarily against the Market Maker's principal account.

This chapter will focus on ECNs since orders or quotes submitted to this type ATS can affect a members ability to comply with the SEC's Quote and Limit Order Display (Rule 11Ac1-4) Rules. Together, these rules are referred to as "the Order Handling Rules" because they dictate how Market Makers must display their quotes and handle customer limit orders.

Limit Order Display Rule

The SEC Limit Order Display Rule requires Market Makers that accept customer limit orders to display those limit orders in the their Nasdaq quotes if one or more the limit orders would improve the Market Maker's quote. The rule also requires Market Makers to display customer limit orders in their Nasdaq® quotes (by increasing their quoted size) if one or more of the limit orders is priced equal to the Market Maker's quote and that price is equal to the national best bid or offer. As an alternative to displaying these limit orders in their quotes, Market Makers can either execute the orders immediately upon receipt or deliver the orders to an ECN that is linked with Nasdaq.

SEC Quote Rule

The SEC Quote Rule, among other things, requires Market Makers to provide Nasdaq with any quote or customer limit order that a Market Maker submits to an ECN, unless the ECN to which the order or limit order was submitted is linked to Nasdaq.

Linked ECNs

Under both of these rules, a Market Maker's obligation to handle a quote or customer limit order in a certain manner will depend on whether the quote or limit order has been delivered to an ECN that is linked with Nasdaq. To summarize, a Market Maker that submits a quote or customer limit orders to a non-linked ECN and does not also reflect that quote or limit orders in its Nasdaq quote will have violated the SEC Quote Rule and/or the SEC Limit Order Display Rule. In contrast, a Market Maker that submits such quote or limit orders to a linked ECN will not have to change its quote in Nasdaq and will be in compliance with the SEC Rules.

Obviously, it is important to know the difference between a linked and non-linked ECN. A linked ECN is one that displays its best prices in Nasdaq and allows Nasdaq subscribers to access those prices electronically through the Nasdaq Workstation II® (NWII‰). A linked ECN displays its best price(s) and size(s) in the quote montage along with its Market Maker identifier (MMID). Nasdaq appends a unique fifth-character identifier to the right of the ECN's MMID to distinguish the quote from one displayed by a Market Maker.

The linked ECNs currently include Archipelago (ARCA), ATTAIN (ATTN), Brass Utility L.L.C., (BRUT), B-Trade Services(BTRD), Instinet (INCA), The Island ECN, Inc. (ISLD), MarketXT (MKXT), Spear Leeds and Kellogg (REDI), and NexTrade (NTRD). SelectNet‰ Broadcast is an ECN under the SEC's definition, but it is not a linked ECN because Broadcast orders are not included in the Nasdaq quote montage and do not set the inside market. Accordingly, Market Makers may not use the SelectNet Broadcast to satisfy the display alternative in the SEC Rules.

Linked ECNs—Participation in SuperSoes

Linked ECNs may choose how they accept orders in SuperSoes℠. An ECN can participate either as a full participant ECN or as an order-entry ECN. Full participant ECNs provide automatic execution for orders received through SuperSoes, and likewise can send orders to Market Makers or other full participant ECNs for automatic execution. Full participant ECNs are identified by a fifth character "+" symbol in their Nasdaq MMID.

Order-entry ECNs do not automatically execute orders received through SuperSoes. To access an order-entry ECN's quote/order, a market participant must send the ECN a SelectNet message. Order-entry ECN are identified by a fifth character "#" symbol in their Nasdaq MMID. Order-entry ECNs, however, can enter orders in SuperSoes to access other market participants' quotes.

ECNs and Other SEC and NASD Rules

ECNs are broker/dealers or are sponsored by broker/dealers that are members of the National Association of Securities Dealers, Inc. (NASD®), and as such, are obligated under the SEC Quote Rule to be firm for the price and size of the order they display, unless a firm quote exception applies.

Locked/Crossed Market Rule

With regard to the locked or crossed market rules, ECNs are subject to NASD rules to the same extent as Market Makers. If an NASD member enters an order into an ECN that would lock or cross the Nasdaq best bid or offer, the member is obliged to take reasonable steps to avoid the lock or cross. One way the member can meet this obligation is to send another order to the market maker or ECN whose quote would be locked or crossed (to take out the quote) before entering the original order into the ECN.

If the order in the ECN is not from an NASD member, the broker/dealer that sponsors the ECN is obliged to take reasonable steps to avoid the lock or cross.

Currently, the ECN can do one of two things: (1) enter an order into SuperSoes or SelectNet (as applicable) to take out the other quote; or (2) not display the order in Nasdaq.

As to the second approach, the SEC Quote Rule only requires ECNs to display the orders of specialists or Market Makers. If the order is from another entity, the ECN does not have to provide that order to Nasdaq, and thus can avoid locking or crossing the market. However, Regulation ATS requires certain ECNs to provide Nasdaq with their best priced buy and sell orders from all types of subscribers, not just specialists and Market Makers. The second option is not available for ECNs subject to this requirement.

Disruption of Service

If an ECN's link to Nasdaq is disrupted so that the ECN cannot correctly show its prices on Nasdaq or if order-entry ECNs cannot accept SelectNet, the ECN becomes a non-linked ECN until the problem is corrected. During the time that the link is disrupted, Market Makers that use the ECN to enter customer or proprietary orders must change their quotes in Nasdaq to reflect the quotes/orders they are putting into the ECN/ATS.

The SEC allows linked ECNs to charge a service fee to anyone that accesses their quotes through SelectNet or SuperSoes. Each ECN determines whether or not to charge for such access, and how much the charge will be. If an ECN charges for access, the ECN contacts each firm that accesses the ECN through SelectNet or SuperSoes and bills that firm directly for that access.

Phone Numbers

Nasdaq Office of General Counsel	(202) 728-8294
MarketWatch	
Trade Reporting Rules, Complaints	(800) 211-4953
StockWatch Section (Trading Halts)	(800) 537-3929

Revised October 2000

Exchange-Listed Securities

National Association of Securities Dealers, Inc. (NASD®) member firms are permitted to trade exchange-listed securities (Consolidated Quotation Service [CQS] securities) as principal in certain circumstances, and The Nasdaq Stock Market, Inc. provides quoting and execution services to accommodate Market Makers and order-entry firms in Nasdaq InterMarket℠ trading.

Initial Registration as a CQS Market Maker

Quotations in exchange-listed securities can only be entered into the Nasdaq® system by NASD members that are registered as CQS Market Makers. If you are seeking registration as a CQS Market Maker for the first time, you must file an application with Nasdaq Subscriber Services at (800) 777-5606. You must meet financial responsibility requirements and have a valid clearing arrangement with the National Securities Clearing Corporation (NSCC).

Your registration as CQS Market Maker becomes effective upon approval. On that date, you may enter quotes into the Nasdaq system as a CQS Market Maker. You must register for each additional CQS security that you wish to trade as a Market Maker, and may do so by fax at (203) 385-6555.

Each day the primary exchange opens a particular security for trading, you are allowed to trade the security before the primary exchange does, but that action precludes all CQS Market Makers from participating in the exchange's pre-opening indication. This pertains only to Intermarket Trading System (ITS) eligible securities that send out pre-opening indications to Nasdaq.

If you do not enter quotes for a particular security on the effective date of your registration in that security and do not enter quotes for five consecutive business days thereafter, your registration as a CQS Market Maker in that security will be terminated and you must go through the initial registration process again to re-register.

Withdrawal of Quotations and Termination of Registration

If you are a CQS/Computer Assisted Execution System℠ (CAES℠) Market Maker, you may contact the CAES/ITS Service Desk to obtain an excused withdrawal in a CQS security.

An excused withdrawal in a CQS security is valid for up to five business days, if based on an illness, vacation, or physical circumstance beyond your control. The length of the withdrawal may be extended beyond the five-day period by contacting the CAES/ITS Service Desk. An excused withdrawal for up to 60 days may be approved, if based on investment activity or advice of counsel. The request must be made in writing and must include a representation that the withdrawal is not permanent in nature.

Circumstances that do not warrant an excused withdrawal include: pending news; a sudden influx of orders or price changes; or transactions with competitors. When your quote is reduced to zero by executions in CAES and/or ITS, CAES will place you in a functionally excused withdrawal state until you update your quote.

Voluntary Termination as a CQS Market Maker

By withdrawing your quotes from a particular CQS security on an unexcused basis, you terminate your registration as a CQS Market Maker for that security voluntarily. If you terminate your registration from a security voluntarily, you may not re-register as a CQS Market Maker in that security for two business days.

CQS Market Maker Obligations

A CQS Market Maker must be open for business from 9:30 a.m. to 4:00 p.m., Eastern Time (ET), at least. You have the ability to designate a closing time for each security between 4:00 p.m. and 6:30 p.m., ET, but the closing time must be on the hour or the half-hour. If you have closed your market, you may re-open it as late as 6:29:59 p.m., ET, upon notification to the CAES/ITS Service Desk.

Quotation Requirements

A CQS Market Maker must maintain continuous, two-sided quotes. Your quotations are required to be firm up to their displayed size. The minimum quote size for CQS securities is 100 shares (i.e., 1 x 1).

There is no longer a requirement regarding excess spreads.

Locked and Crossed Markets

If you are a CQS or CAES/ITS Market Maker that makes a bid or offer, and in doing so you create a locked or crossed market with another ITS participant or CAES/ITS Market Maker, you must promptly send the other participant a commitment to trade seeking either the bid or offer that was locked or crossed. There are specific rules that speak to further obligations, as well as to instances when Market Makers are excused from this commitment. Contact the CAES/ITS Service Desk at (203) 385-6399 for more information.

Autoquote Policy

NASD Rule 6330(d) explicitly permits the following uses of computer-generated quote updates:

- an update in response to an execution;
- a manual entry into a firm's system that then routes the update to the Nasdaq system;

- an update to reflect the receipt, execution, or cancellation of a customer limit order;
- exposing an order for price improvement; and
- equaling or improving either or both sides of the national best bid and offer (NBBO), or adding size to the NBBO.

These changes explicitly accommodate computer-generated quotations that add value to the market and do not raise quotation accessibility concerns or compromise the capacity or integrity of Nasdaq. In this regard, it is important to note that Market Makers are prohibited from using computer-generated quotes to move away from the inside market ("autoquoting away"). Thus, the new rule will permit computer-generated quotations in exchange-listed securities that generate proprietary quotes for 100 shares or more if such quote systems equal or improve either or both sides of the NBBO.

Trade Practices

If your firm trades CQS securities, you must abide and adhere to the following conditions and requirements when trading CQS securities for your own account or for your customers:

- You are not permitted to execute an over-the-counter (OTC) transaction in a CQS security subject to an initial public offering until that security has first opened for trading on the primary exchange listing the security, as indicated by the dissemination of an opening transaction on the consolidated tape.
- You are prohibited from buying/selling a CQS security for your own account while you hold a customer's unexecuted market order to buy/sell such security.
- You are prohibited from buying/selling a CQS security for your own account at a price equal to or below/above the limit price of a customer's unexecuted limit order to buy/sell.

There are exceptions to the second and third bullets listed on the previous page. Those provisions do not apply to any purchase or sale for which a member has negotiated specific terms and conditions applicable to the acceptance of limit orders that are: for institutional accounts (as defined in Rule 3110[c][4]), or for 10,000 shares or more, unless such orders are less than $100,000 in value.

Transaction Reporting for CQS Securities

For more information on transaction reporting for CQS securities, see Chapter 5.

CAES

CAES is an order delivery and execution system that allows you to direct agency orders in exchange-listed issues (CQS stocks) to Nasdaq Market Makers for execution. CAES automatically does the following with each execution:

- sends an execution report to both the order-entry firm and the executing Market Maker(s);
- transmits a trade report for display on Nasdaq Workstations and the consolidated tape; and
- submits trades to clearing as “locked-in.”

CAES accepts directed limit orders. Orders may be designated to a specific Market Maker or entered as undesignated to all CAES Market Makers at the consolidated bid or offer (BBO).

ITS

ITS provides the link between Nasdaq (the Nasdaq InterMarket) and other ITS participant exchanges in exchange-listed issues. The ITS system allows for either automatic execution or delivery of an ITS commitment.

The ITS interface allows you, as a participant, to direct orders to and receive orders from other participant exchanges. Operation of the ITS/CAES link is governed by a national market system plan known as the “ITS Plan.” An ITS order must be directed to a participant exchange, may be sent in either agency or principal capacity, and may be sent as either a market or limit order.

The participating ITS exchanges, and their identifying symbols are:

■ Nasdaq	(T)
■ American Stock Exchange®	(A)
■ Boston Stock Exchange	(B)
■ Chicago Board Options Exchange	(W)
■ Chicago Stock Exchange	(M)
■ Cincinnati Stock Exchange	(C)
■ New York Stock Exchange	(N)
■ Pacific Stock Exchange (Los Angeles and San Francisco)	(P)
■ Philadelphia Stock Exchange	(X)

Phone Numbers

CAES/ITS Service Desk	(203) 385-6399
Nasdaq InterMarket Market Services	(202) 974-2110
Nasdaq Subscriber Services	(800) 777-5606
Nasdaq Office of General Counsel	(202) 728-8294

Fax Number

CAES/ITS Service Desk	(203) 385-6555

Revised January 2000

Regulatory Requirements

Prohibitions Against Anti-Competitive Behavior

The Nasdaq Stock Market, Inc. supports an open and equitable trading environment for all market participants, and the National Association of Securities Dealers, Inc. (NASD®) has established rules to foster fair practices and prohibit anti-competitive behavior. Specifically, NASD Conduct Rule IM-2110-5 identifies certain conduct that is inconsistent with just and equitable principles of trade. Neither your firm nor anyone associated with your firm should:

- coordinate prices (including quotations), trades, or trade reports (including agreements to report trades late or inaccurately, or agreements to maintain certain minimum spreads or quote sizes) with any other member firm or person associated with a member firm;
- direct or request another member firm to alter a price (including a quotation) in situations where one Market Maker requests another to move or adjust its displayed quotations to accommodate the requesting Market Maker; or
- engage, directly or indirectly, in any conduct that threatens, harasses, coerces, intimidates, or otherwise attempts improperly to influence another member firm or person associated with a member firm. This includes any attempt to influence another member firm to adjust or maintain a price or quotation on any automated system operated by Nasdaq®, and refusals to trade or other conduct that retaliates against or discourages the competitive activities of another Market Maker or market participant.

Activities Not Constrained by the Interpretation

The interpretation of NASD Conduct Rule IM-2110-5 also sets forth specific exclusions that identify bona fide commercial activities by and among member firms that are not prohibited by the interpretation—or are, in other words, acceptable practices. Specifically, there is nothing in the interpretation that is meant to limit, constrain, or otherwise inhibit the freedom of your firm or anyone associated with it to conduct fair and legitimate trades. For example:

- Your firm may set its own bid and ask in any Nasdaq security, the prices at which it is willing to buy or sell any Nasdaq security, and the quantity of shares of any Nasdaq security that it is willing to buy or sell.
- You may set your own dealer spread, quote increment, or quantity of shares for your quotations in any Nasdaq security. You may also set any relationship between or among your dealer spread, inside spread, or the size of any quote increment in any Nasdaq security.
- Your firm may communicate its own bid or ask to explore the possibility of a purchase or sale of that security, and to negotiate or agree to, that purchase or sale.
- You may communicate your firm's own bid or ask for the purpose of retaining an agent or subagent for your firm or for a customer of your firm (or to be retained as an agent or subagent).
- Your firm may engage in any underwriting (or any syndicate for the underwriting) of securities to the extent permitted by the federal securities laws.
- You may take any unilateral action or make any unilateral decision regarding the Market Makers with which your firm will trade and the terms on which it will trade, unless such action is prohibited by the interpretation.
- You may deliver an order to another member for handling.

Best Execution Requirements

The duty of "best execution" arises from the common law duty of loyalty owed by a broker to its retail customers. The Securities and Exchange Commission (SEC) has stated that "when an agent acts on behalf of a customer in a transaction, the agent is under a duty to exercise reasonable care to obtain the most advantageous terms for the customer." This principle has been incorporated into case law and SEC decisions under the federal securities laws and must be adhered to whether acting as agent or in a principal capacity.

It is important to note that the application of "best execution" involves analysis of the "facts and circumstances." Actions that in one set of circumstances may meet your firm's best execution obligation, may not meet that standard in another set of circumstances. It should also be noted that the best execution obligation evolves as rules and systems change. Your firm should review its execution practices, as appropriate, to ensure compliance with new rules, systems, or market conditions.

The SEC has stated that, as a general matter, the duty of best execution refers to your duty to seek to execute your customer's order in the best available market. NASD Conduct Rule 2320 states that in any transaction with or for a customer, a member and its associated persons must use reasonable diligence to ascertain the best inter-dealer market for the security and buy or sell in such market so that the price to the customer is as favorable as possible under prevailing market conditions. Among the factors that will be considered in applying the standard of reasonable diligence are as follows:

- character of the market price, volatility, relative liquidity, and pressure on available communications;
- size and type of transaction;
- number of primary markets checked; and
- location and accessibility to the customer's broker/dealer of primary markets and quotations sources.

Effect of SEC Order Handling Rules

The questions and answers that follow attempt to provide you with answers to compliance questions raised following the implementation of the SEC Order Handling Rules. The discussion that follows relates primarily to the handling of orders in Nasdaq National Market® and The Nasdaq SmallCap Market℠. Since the NASD Limit Order Protection Rule (Manning Rule) only applies to Nasdaq securities, the limit order protection requirements discussed below do not necessarily apply by specific rule to over-the-counter equity securities that may be quoted on the OTC Bulletin Board® (OTCBB). Of course, you continue to have best execution obligations for these securities. Please note that the protection of limit orders in exchange-listed securities executed in the “Third Market” is governed by NASD Rule 6440 and that you continue to have best execution obligations for these securities as well. You are advised to read *NASD Notice to Members 97-57* for a more detailed explanation of the answers provided below.

A guiding principle concerning best execution can be found in the SEC’s statement about the matching of market orders and limit orders in its release adopting the Order Handling Rules. Specifically, the SEC stated that when a Market Maker holds an undisplayed limit order priced better than the quote, and it subsequently receives a market order on the opposite side of the market from the limit order, it is no longer appropriate for the Market Maker to execute the market order at the published quote and the limit order at its limit price. The Market Maker must pass along the price improvement of the limit order to the market order.

Questions and Answers

Q. **Basic Obligation:**
The inside market on Nasdaq is 10 – 10 1/2, 10 x 10. Market Maker A (MMA) holds a customer limit order to buy 1,500 shares at 10 1/4, which the customer has requested not be displayed. MMA receives a market order to sell 1,000 shares from another customer through its internal order delivery and execution system. What must MMA do?

A. MMA must execute the market order at 10 1/4, the price of the undisplayed limit order. MMA may execute the market order against the limit order or against its own inventory. However, if it fills the market order out of its own inventory, the Manning Rule requires that MMA protect the limit order at its price (i.e., 10 1/4). The remaining 500 shares of the limit order would continue to reside undisplayed on MMA's book.

Q. **System Orders:**
The inside market on Nasdaq is 10 – 10 1/2, 10 x 10. Market Maker A(MMA) holds a customer limit order to buy 1,500 shares at 10 1/4, which the customer has requested not be displayed. MMA receives a customer market order to sell 1,000 shares from another broker/dealer through MMA's automated order delivery and execution system. At what price should the limit and market orders be executed?

A. Both the market order and the limit order must be executed at 10 1/4. Even though the order is from another broker/dealer, the other firm has routed its order with the understanding that MMA will provide automated executions for that broker's customer orders and thereby provide best execution through MMA's system. Therefore, MMA must match (as principal or as agent, as explained in the above answer) the 1,000-share customer market order against 1,000 shares of the undisplayed customer limit and execute at 10 1/4. The remaining 500 shares of the 10 1/4 limit order remain undisplayed on MMA's files.

Q. **Phone Orders Where the Market Maker and Order-Entry Firm Have a Relationship:**

The inside market on Nasdaq is 10 – 10 1/2, 10 x 10. Market Maker A (MMA) holds a customer limit order to buy 1,500 shares at 10 1/4, which the customer has requested not be displayed. MMA's public bid in the stock is 10. Broker/dealer B (BDB) telephones MMA to sell 1,000 shares at the market for a customer. MMA has an arrangement with BDB that MMA will provide BDB's customers' orders with best execution—such as part of a payment for order flow, reciprocal, or correspondent arrangement. What is MMA's obligation to BDB and to the limit order to buy?

A. Both the market order and the limit order must be executed at 10 1/4. Even though the order is from another broker/dealer, MMA must match 1,000 shares of BDB's customer order against the undisclosed limit order of 10 1/4, because MMA has an arrangement under which it has implicitly or explicitly undertaken to provide best execution to BDB's customers' orders

Q. **Phone Orders Where the Market Maker and Order-Entry Firm Do Not Have a Relationship:**

The inside market on Nasdaq is 10 – 10 1/2, 10 x 10. Market Maker A(MMA) holds a customer limit order to buy 1,500 shares at 10 1/4, which the customer has requested not be displayed. MMA's public bid in the stock is 10. Broker/dealer B (BDB) telephones MMA to sell 1,000 shares at the market for BDB's own account, where MMA has no agreement or understanding to treat BDB's orders as customer orders or otherwise provide them with best execution. What is MMA's obligation to BDB and to the limit order to buy?

A. MMA may execute BDB's market order to sell at MMA's published quote of 10. MMA does not owe a best execution obligation to a non-customer where no understanding or expectation of treatment as a customer has been reached by MMA and BDB. Broker/dealers are not considered customers for purposes of this obligation. If MMA executes BDB's order at 10, MMA has traded through the customer limit order it holds, however. Thus, under the Manning Rule, MMA must execute 1,000 shares of the limit order it holds.

Q. Rounded Orders:
The inside market on Nasdaq is 20 – 20 1/2, 10 x 10. Market Maker A (MMA) holds a customer limit order to buy 2,000 shares of a Nasdaq stock at 20 5/32. MMA changes its bid to 20 1/8 for 2,000 shares to reflect the rounded price of the customer limit order. MMA receives a market order to sell 2,500 shares. At what price must the market and limit orders be executed?

A. MMA must execute the customer limit order and 2,000 shares of the market order at 20 5/32, even though its displayed quote was rounded to 20 1/8. The execution must occur at the actual limit order price that MMA held.

Q. Execution Price:
The inside market on Nasdaq is 10 – 10 1/2, 10 x 10. Market Maker A (MMA) holds a customer limit order to buy at 10 1/4 for 1,500 shares that the customer requests not be displayed. MMA receives a customer limit order to sell 1,000 shares at 10 1/8. At what price(s) should the limit orders be executed?

A. MMA should execute the sell limit order against the buy limit order at 10 1/4. In essence, the second limit order is a marketable limit order that is the equivalent of a market order and should be treated as such under the best execution principles discussed by the SEC.

Q. Minimum Price Improvement To Avoid Manning Violation:
The inside market on Nasdaq is 20 – 20 1/4, 10 x 10. Market Maker A (MMA) receives a customer limit order to buy 2,000 shares at 20 1/16. MMA changes its quote to 20 1/16 for 2,000 shares to reflect the price of the customer limit order. MMA receives a market order to sell 2,500 shares. May MMA offer the market order price improvement over the 20 1/16 limit order and execute the market order for its own account? If so, what is the minimum amount of price improvement allowable?

A. MMA must execute the market order at a price at least 1/16 better than the limit order price so as not to violate the NASD Limit Order Protection Rule. However, when the actual quotation spread is the minimum quotation increment, the minimum price improvement is one-half of the normal minimum quote increment. For example, if the actual spread were 20 1/16 – 20 1/8, as in the above example, MMA could purchase the stock at a price of 20 3/32 and not violate the Limit Order Protection Rule. Similarly, if the security were priced under $10 and quoted at 5 1/32 – 5 1/16, the minimum price improvement to avoid a violation of the Manning Rule would be 1/64.

Q. Discretionary or Working Orders:
The inside market on Nasdaq is 10 – 10 1/8, 10 x 10. Market Maker A's (MMA) quote in the stock is 9 7/8 – 10 1/4. MMA receives a 100,000 share discretionary ("working") order to buy in which the institutional customer and the Market Maker agree to the terms of the order and the compensation that MMA is to receive. MMA and the institutional customer agree that MMA may—if necessary to fill the entire order at an acceptable price—trade ahead of the institutional customer's order. MMA immediately sells 30,000 shares to the institution and holds the remaining 70,000 shares.

Here are three scenarios:

1. MMA executes an undisplayed limit order to sell at 10 1/16 for 1,000 shares.
2. MMA executes a market order to sell for 1,000 shares at 10.
3. MMA executes an order to sell 10,000 shares at 9 7/8.

What are MMA's responsibilities to the 70,000 share order when it executes any of the orders described in scenarios 1, 2, or 3?

A. Because MMA has been given discretion by its customer to work the order, MMA does not owe the same best execution obligations to it and to other crossing orders as it would if the order were a non-discretionary market or limit order. Thus, where beneficial to the discretionary order, MMA may trade at 10 1/16 or lower with incoming orders without necessarily triggering a fill for the discretionary order it holds. Because the discretionary order is not a priced order, there are no Manning obligations to the order, nor is there a specific price at which an incoming order can be matched.

MMA must clearly document that it has obtained the authorization of its customer to work the order and must disclose to the customer that such discretion means that the firm may trade at the same price or at a better price than that received by the discretionary order. In addition, it should be noted that, because the customer has granted the Market Maker the discretion to work the order, the Market Maker, as agent, has a clear responsibility to work to obtain the best fill considering all of the terms agreed to with the customer and the market conditions surrounding the order. In the absence of a clear understanding between the trader and the customer regarding MMA's activities in competing with the customer order, MMA could potentially violate its fiduciary duties to its customer in the way it "works" the order.

Q. Discretionary Orders With a Cap:
The inside market on Nasdaq is 10 – 10 1/4, 10 x 10. MMA accepts a discretionary order to buy 100,000 shares with a cap of 10 3/16. MMA receives a market order from a customer to sell 1,000 shares. Does MMA have to match the market order against the discretionary order that has a cap?

A. MMA does not have to match the market order against the discretionary order and MMA is able to buy from the market order at its bid of 10, assuming that this handling benefits the discretionary order. The discretionary order with a cap is not considered a limit order because the firm is "working" the order and may be able to execute it at prices other than the 10 3/16 cap price.

Q. Execution of Blocks Outside the Inside Market Price:
The inside market on Nasdaq is 10 – 10 1/4, 10 x 10. Market Maker A (MMA) accepts a customer limit order to buy 1,000 shares at 10 1/8 that the customer requests not be displayed. MMA negotiates with an institution to buy 100,000 shares at 9 7/8. Does MMA have to execute the 1,000-share limit order at 9 7/8?

A. No. While MMA has a Manning obligation to execute the limit order, MMA can execute the limit order at its stated price of 10 1/8. In addition, MMA is not obligated to execute 1,000 shares of the 100,000-share block at 10 1/8, assuming that MMA has clearly disclosed to the institution that it intends to handle the order in this manner, and the institution has agreed to this practice.

Q. **Net Trades/Internal Sales Credits:**
The inside market on Nasdaq is 20 – 20 1/4, 10 x 10. Market Maker A (MMA) holds a limit order to buy 1,000 shares at 20. MMA receives from an institution a limit order to sell 9,000 shares "net" at 20. What effect does the "net" sell order have on MMA's Manning or best execution obligations?

A. MMA must execute the net sell order at 20 by matching (as principal or as agent) the limit order to buy at 20 against the net sell order first, and then execute the remainder of the net order against its inventory.

Q. **Net Trades/Internal Sales Credits:**
Assuming the same facts as above, does the answer change if Market Maker A (MMA) discloses to the institutional customer with the sell limit order that the sales representative is to obtain a 1/8 sales credit and thus, MMA will be holding the limit order at a price exclusive of the sales credit?

A. If MMA chooses to disclose the internal sales credit to the institutional customer and explains that the 20 net price is to be affected by this sales credit, and the customer agrees to this arrangement, then MMA should hold the limit order to sell at 20 1/8 and display the order in its quote, unless an exception to Rule 11Ac1-4 is available. Thus, the inside market would move to 20 – 20 1/8, 10 x 90. Accordingly, because the net limit order to sell was held at a price (20 1/8) that does not match against the limit order to buy at 20, there is no execution.

Prohibitions Against Frontrunning

Your firm is prohibited from trading in options while in possession of material, non-public information of an imminent block transaction in the underlying security of that option. You are also prohibited from trading in an underlying security while in possession of material, non-public information of an imminent block transaction in an option overlying the security.

A transaction involving 10,000 shares or more of an underlying security—or options covering that number of shares—is generally deemed to be a block transaction. (A transaction of less than 10,000 shares could be considered a block transaction in appropriate cases.) A block transaction that has been agreed upon does not lose its identity as such where partial executions of the full transaction occur in portions, which themselves are not of block size, if the execution of the full transaction may have a material impact on the market.

This frontrunning policy applies to transactions in exchange-listed securities, Nasdaq-listed securities, and exchange-listed options.

Transactions executed based on knowledge of less than all of the terms of the block transaction may still be considered frontrunning—that is, a prohibited action—so long as there is knowledge that all of the material terms of the transaction have been or will be agreed upon imminently.

The general prohibitions stated above do not apply to transactions that you execute through automatic execution systems where you must accept the automatic executions.

These prohibitions do not apply to situations in which your firm or a person associated with your firm receives a customer's order of block size relating to both an option and the underlying security. In such cases, you may position the other side of one or both components of the order. However, in these instances, you would not be able to cover any resulting proprietary position(s) by entering an offsetting order until information concerning the block transaction involved has been made publicly available.

Prohibition Against Trading Ahead of Research Reports

NASD Conduct Rule IM-2110-4 prohibits member firms from purposefully establishing or adjusting the firm's inventory position in Nasdaq-listed securities, exchange-listed securities traded on the OTC market, or derivative securities based primarily on a specific Nasdaq- or exchange-listed security, in anticipation of the issuance of a research report in that same security.

The following is an example of prohibited behavior:
Your research department may prepare a research report recommending the purchase of a particular Nasdaq-listed security. Prior to the publication and dissemination of the report, however, your trading department might purposefully accumulate a position in that security to meet anticipated customer demand for that security. After your firm had established its position, it would issue the report, and thereafter fill customer orders from your inventory positions.

For purposes of this interpretation, a “purposeful” change in your firm’s inventory position means any trading activities undertaken with the intent of altering your position in a security in anticipation of accommodating investor interest once the research report has been published. Hence, the interpretation does not apply to changes in an inventory position related to unsolicited order flow from your firm’s retail or broker/dealer client base, or to research done solely to aid in-house trading and not in any way used for external publication.

Under the interpretation, it is recommended (but not required) that your firm develop and implement policies and procedures to establish effective internal control systems, and procedures that would isolate specific information within research and other relevant departments of the firm to prevent the trading department from utilizing the advance knowledge of the issuance of a research report. Firms that choose not to develop “Chinese Wall” procedures bear the burden of demonstrating that the basis for changes in inventory positions in advance of research reports was not purposeful.

Special Requirements for Non-Nasdaq Securities (Three Quote Rule)

NASD Conduct Rule 2320(g) requires that in any transaction for or with a customer pertaining to the execution of an order in a non-Nasdaq security or a non-exchange-listed security, a member firm or person associated with a member firm shall contact and obtain quotations from three dealers (or all dealers if three or less) to determine the best inter-dealer market for the subject security. To comply with the rule, a person associated with your firm must indicate on the memorandum for each transaction subject to the rule, the name of each dealer contacted and the quotations received to determine the best inter-dealer market.

If the OTCBB displays three firm quotations, you are not required to call the three Market Makers to verify the firm quotations that are displayed on the screen. Rather, you need only note on the order ticket, the identity of the broker/dealers, and the firm quotations obtained from the OTCBB. You could also print a copy of the screen and attach the copy to the order ticket.

Non-firm quotations on the OTCBB cannot be used to satisfy the requirement that quotations be obtained from other Market Makers. If the OTCBB has one firm quote and two name-only quotations, you must call the name-only Market Makers to obtain the three required quotations.

If the OTCBB has fewer than three Market Makers listed, you must check the “Pink Sheets” or any other quotation medium for additional Market Makers. A Market Maker in these quotation mediums must be contacted to obtain its current quotations. If three Market Makers cannot be found, then you need only contact the one or two that you do find.

On occasion, the application of the Three Quote Rule may hinder your best execution obligation due to time delays involved. Several market participants have questioned the value of the Three Quote Rule, pointing in particular to foreign securities traded on foreign exchanges, but not on U.S. exchanges. For these foreign exchanges, taking the time to contact three dealers before executing the transaction could hinder best execution. In such cases, exemptions from the rule may be considered. For more details, please see *NASD NTM 97-88*.

Phone Number

NASD Regulation, Inc., Market Regulation	(301) 590-6410
Nasdaq Office of General Counsel	(202) 728-8294

Revised January 2001

ACT Requirements

The Automated Confirmation Transaction Service℠ (ACT℠) was developed for National Association of Securities Dealers, Inc. (NASD®) members to use in comparing trade information and submitting locked-in trades to the National Securities Clearing Corporation (NSCC) for clearing. ACT also accommodates all of Nasdaq® trade reporting. Nasdaq execution systems, such as the Small Order Execution System℠ (SOES℠) and SelectNet®, have an automated interface with ACT and automatically route execution reports through ACT for reporting and comparison.

Participation in ACT is mandatory for your firm if:

- it is an NASD member in good standing;
- it has executed, and continues to be in compliance with, an ACT Participant Application Agreement; and
- it is a member of a clearing agency registered with the Securities and Exchange Commission (SEC), or has a clearing arrangement with such a member.

Nasdaq Market Makers are required to submit trade reports through ACT, within 90 seconds of execution (*see Chapter 5 for additional information*) for trade reporting and clearing purposes. Similarly, order entry-firms are required to submit details of the trade, or accept or decline the Market Maker's entry, using the ACT browse function on the Nasdaq Workstation II®(NWII™) within 20 minutes of the trade. Participants may also use the browse function to change the status of desired trades by entering a different code into the system.

The browse function is accessed through the "Scan" menu by selecting "ACT." An order-entry firm can perform three changes:

- U (uncompared) trades may be changed to either A (accepted) or D (declined).
- O (open) trades may be changed to C (canceled).
- D (declined) trades may be changed to A (accepted).

A Market Maker may also make three changes:

- U (unanswered) may be changed to C (canceled) or E (error).
- O (open) may be changed to D (declined).
- D (declined) may be changed to C (canceled) or E (error).

The Market Maker trade correction (No/Was) function may also be used to correct a previously entered original trade that is unanswered or declined by the order-entry side or that was submitted for trade reporting purposes only.

Hours of Operation

ACT is open for trade report input daily from 8:00 a.m. to 6:30 p.m., Eastern Time (ET). ACT also operates a service desk for small-sized firms with infrequent transactions. To see if your firm qualifies for the ACT Service Desk, contact the ACT Service Desk at (203) 378-0166.

ACT As-of Trades

The As-Of Trade-Entry function allows a subscriber to enter a previously executed trade on an As-Of basis for a period of up to one calendar year. The ACTII entry time is from 8:00 a.m. to 6:30 p.m., ET.

T+N entries may be submitted until 6:30 p.m., ET, each business day. At the end of daily matching, all declined trade entries will be purged from the ACT system. ACT will not purge any open trade (i.e., unmatched or unaccepted) at the end of its entry day, but will carry-over such trades to the next business day for continued comparison and reconciliation. ACT will automatically lock in and submit to NSCC as such any carried-over T to T+21 (calendar day) trade if it remains open as of 2:30 p.m. on the next business day. ACT will not automatically lock in T+22 (calendar day) or older open "as-of" trades that were carried-over from the previous business day; these will be purged by ACT at the end of the carry-over day if they remain open. Members may re-submit these T+22 or older "as-of" trades into ACT on the next business day for continued comparison and reconciliation for up to one calendar year.

ACT will no longer perform an on-line M2 match in the afternoon of the second day. The M2 match will only be performed at the end of the entry day.

As-Of trades will be included in ACT's Risk Management calculations and will be subject to Blockbuster and Sizable Trade Clearing Firm authorization when limits have been exceeded.

ACT As-Of Trade Reversals

The ACT Trade-Reversal function allows participants to cancel out the effects of a prior trade submission to the NSCC. The As-Of Trade-Reversal function will be subject to the same rules as the previously described As-Of Trade-Entry function.

The participant will need to reverse the side of the trade when submitting an As-Of Trade Reversal into ACT. For example, if the subscriber wishes to cancel a previously submitted sell trade, the subscriber must submit an As-Of Reversal trade as a buy.

The subscriber will also have the ability to enter an As-Of Reversal function on a net position basis. For example, if a subscriber entered a sell trade for 1,000 shares but the trade should have been for 800 shares, the subscriber may enter an As-Of Trade Reversal for 200 shares as a buy to net the position to the correct amount. This can be done in lieu of an As-Of Trade-Reversal buy for 1,000 shares and an As-Of trade sell for 800 shares.

Form T Trade Reporting

Both the As-Of Trade Entry and Trade Reversal functions described previously can be used to satisfy Nasdaq's Form T reporting requirements. Subscribers may report or correct a previously made entry for a period of one year after trade date. Members are required to submit trades electronically.

ACT Trade Step Outs

ACT provides a Step-Out transaction indicator to allow members to identify uniquely Step-Out "clearing-only" entries submitted to ACT for comparison and clearance through the NSCC. ACT provides a separate Step-Out selection option on the ACT Trade Scan window that allows firms to view all their Step-Out entries at one time. These trades will not be reported to the tape nor disseminated to the media.

A Step Out allows Broker A (executing broker) to "Step Out," or allocate all or part of the trade(s) to another broker/dealer(s) (Broker B). Broker A will submit an ACT Market Maker (MM) entry that is flagged as a Step Out against Broker B. In addition, Broker B will be required to acknowledge the trade by either accepting the trade or submitting a matching order-entry (OE) firm entry that is also flagged as a Step Out. Since the Step-Out flag will be a part of the matching criteria, an omission of the flag by either side will cause the trade not to match. Once the trade has matched, it will be submitted to the NSCC for clearance and will include the Step-Out flag for identification purposes.

Give-Ups

"Give-Up" trades enable executing broker/dealers to submit trades to ACT on behalf of a participant broker/dealer. The participant broker/dealer, in turn, agrees to accept and honor all trades reported on its behalf, while the executing broker/dealer adheres to the rules and provisions of ACT trade reporting. The ACT Give-Up Automatic Lock-In function allows an introducing broker to enter and lock-in a trade when it is responsible for both sides of the trade. This occurs when two of its “give-ups” trade with each other or the introducing broker trades with one of its own give-up firms. Currently, the introducing broker may submit an MM entry for one side and either accept the trade or submit an OE entry to match the trade. By specifying the Give-Up Lock-In feature, the introducing broker avoids the need to accept the trade or submit the OE side. ACT will submit this trade to the NSCC as an M1 Matched Locked-In trade. To establish a give-up relationship with another firm, both firms must execute and submit to The Nasdaq Stock Market, Inc. an Attachment II to the ACT Agreement.

QSR

A QSR (Qualified Special Representative) Agreement enables a special representative, on behalf of the participant broker/dealer, to submit data resulting from trade executions on the special representative’s automated system, directly to NSCC for clearing. The participant broker/dealer agrees to accept the terms of each trade that is reported in this manner. Members that have QSR agreements with NSCC must still use ACT to submit trade reporting information, but because of the QSR relationship, Nasdaq does not submit that information to NSCC for clearing.

ACT Risk Management

The ACT Risk Management function allows firms that clear for other firms to establish acceptable levels of credit for their introducing firms. ACT Risk Management enables clearing firms to monitor buy/sell trading activity of their introducing firms, establish trading thresholds, allow/inhibit large trades, add/delete clearing relationships, and access a real-time database of correspondent trading activity.

Phone Numbers

ACT Service Desk	(203) 378-0166
MarketWatch	(800) 211-4953

Training

To arrange for training or to request training materials, please contact:

Nasdaq Subscriber Training	(212) 858-4084

You may also complete the Subscriber Training request form located at the URL below.
http://nasdaqtrader.com/asp/GetCustomerInfo.asp?2

or send email to Subscribertraining@nasd.com

Training

The Nasdaq® Training Group is located in New York City at 33 Whitehall Street. The staff offers comprehensive, on-site and phone training for member firms on all aspects of Nasdaq Workstation II® (NWII™), including workstation set-up, and how to participate in the Small Order Execution System℠ (SOES℠), SelectNet®, and the Automated Confirmation Transaction Service℠ (ACT℠).

To arrange for training or to request training materials, please contact:

Vito Zerillo (212) 858-4424

For those firms located outside the New York City area, there may be charges associated with having Nasdaq staff travel to your facility for on-site training.